UNIVERSITY OF PENNSYLVANIA

MANAGERIAL PROFIT SHARING

AN EXAMINATION OF THE TECHNIQUE OF BASING THE EXTRA COMPENSATION OF EXECUTIVES AND MANAGERS ON PROFITS

C. CANBY BALDERSTON

A THESIS

IN ECONOMICS

PRESENTED TO THE FACULTY OF THE GRADUATE SCHOOL OF THE UNIVERSITY OF PENNSYLVANIA IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF DOCTOR OF PHILOSOPHY

PHILADELPHIA

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ACKNOWLEDGMENTS

THE author is indebted especially to the counsel and help of Mr. Morris E. Leeds, President of the Leeds & Northrup Company, Philadelphia; and to the advice and criticism of Mr. Henry S. Dennison and Mr. John S. Keir, of the Dennison Manufacturing Company, Framingham, Mass.; Mr. Gorton James, Chief of the Division of Domestic Commerce; Mr. Glenn A. Bowers of Industrial Relations Counselors, Inc.; Professor E. H. Schell of the Massachusetts Institute of Technology; Dr. W. J. Donald, Managing Director, American Management Association; Dr. A. H. Williams, Dr. W. C. Schluter, Dr. C. A. Kulp, and Miss Anne Bezanson of the Wharton School, University of Pennsylvania, also read the manuscript and offered valuable criticism. In addition he wishes to thank Dr. Joseph H. Willits, Professor R. H. Lansburgh, and other members of the Wharton School faculty; Dr. J. Douglas Brown of Princeton University; Mr. C. Reed Cary and C. S. Redding of the Leeds & Northrup Company; Mr. Howard Coonley, President of the Walworth Company; Mr. A. H. Young of Industrial Relations Counselors, Inc.; Mr. F. A. Ketcham of the Graybar Electric Company; Mr. Charles E. Mitchell, President of the National City Company and of the National City Bank; the Policyholders' Service Bureau of the Metropolitan Life Insurance Company, and the many others who have helped and advised him.

This study would have been impossible without the cooperation of the companies which have furnished data regarding plans in operation. Because of the highly confidential nature of the subject, the majority of these companies cannot be mentioned by name. Whatever value this

study may have in answering the debated questions of this form of executive compensation, it owes to these companies which have furnished the background from which to draw conclusions. Also, the half-dozen companies, members of the Business Problems Group, which cooperated by turning over confidential data, have aided greatly in testing the conclusions.

C. Canby Balderston.

MANAGERIAL PROFIT SHARING

INTRODUCTION

Statement of the Problem

THIS study is an attempt to increase the available information as to the value and technique of basing the extra compensation of executives and other members of the managerial group on profits. As a preliminary step, it has been necessary to examine and appraise the existing arrangements for paying part of profits to the active management.

Our problem deals with paying managers not only wages of management but part of the earnings of enterprise; or, as some economists would prefer to state it, with the payment of sums which vary with the earnings of the business, in addition to salaries which are fixed. In this sense, the study may be viewed as an attempt to find a method of compensating executives according to their performance rather than according to the time devoted to the business, just as manual workers are paid piece work, bonus, or premium instead of mere day wages. This study deals with the choice of the most suitable scheme for a given company, then with the structure of existing plans, and lastly with improvements in practice.

Since it is hopelessly confusing to mix "what ought to be" with "what is," and since it is difficult to appraise the equity with which an owner deals with extra earnings, the study itself must be an economic inquiry.[1]

What ought to be done in respect to profits is perhaps a matter for the individual conscience. But the application

[1] Allyn Young: "Trend of Economics," Quarterly Journal of Economics, February, 1925, p. 160.

of whatever ideals an owner may hold as to fair dealing with his co-workers requires a technique if it is to be put into effect on any permanent basis. It is this technique with which we are concerned. The immediate goal is, therefore, to discover, from an analysis of existing plans, how profit-sharing with executives can be made a reliable tool for improving the caliber of management, securing better team work, and helping to insure that the control of the enterprise will be continuous.

Scope of the Study

The analysis has been confined to the sharing of profits with management on a predetermined basis. Since we have restricted ourselves to plans that are definite and fixed in advance, the term "profit-sharing," as we use it, will agree with the time-honored definition: a "voluntary agreement, by virtue of which an employee receives a share, fixed beforehand, in the profits of the undertaking."[2]

However, in respect to the profit-sharers or recipients, our use of the term "profit-sharing" is distinctly different from its meaning in the profit-sharing literature of the past. Whereas the profit-sharing which we are discussing is with management only, the greater part of the literature of the field deals with the distribution of profits to employees below the status of management. The official lists of European countries have barred the "limited" plans with which this book deals. According to the International Cooperative Congress of 1889, held in Paris, "not less than 75 per cent" of the working force must share, for a plan to be true profit-sharing. The survey "Profit-Sharing in the United States," made by Boris Emmet, confined itself to plans under which distributions of specified proportions of the net profits of the enterprise are made to *at least one-third* of the total employed.[3]

[2] International Congress on Profit Sharing, Paris, 1889.
[3] Bulletin of the United States Bureau of Labor Statistics, No. 208, December, 1916.

Profit-sharing for the rank and file was eliminated from this study primarily because its literature is abundant, whereas that of managerial profit-sharing is very meager. In this way the study has been kept within reasonable bounds. This limitation excludes those employees who have jobs below the supervisory or technical positions which can influence earnings to an appreciable degree. Profit-sharing plans for the rank and file appear to have a high mortality rate and to be suitable only for concerns that have made extraordinary progress in the perfection of their personnel management and in "sharing" problems in which their employees have a real interest. Perhaps the difficulty of measuring up to these standards accounts for the large percentage of failures.

In spite of the fact that stock purchase plans are often initiated with purposes similar to those obtainable by sharing profits with management, they have not been considered in this investigation. It has been fairly easy to separate those plans that permit or induce an employee to purchase common or preferred stock, which pays him a dividend on something he has bought, from those plans that give him a share of profits as a reward for unusual effort. Stock ownership for employees, especially for the rank and file, has its own peculiar dangers and advantages which make its treatment as part of this study inadvisable.

Bonuses that are not fixed in advance and that do not bear a definite relation to profits are also excluded. However useful these bonuses may be in creating good-will when a company has had a year of unusual prosperity, they are essentially gifts granted at the whim of the Board of Directors with the advice of the appropriate executives. The fact that such bonuses and Christmas presents have been given out in an indiscriminate fashion year after year may indicate that they do not create any audible ill-will or dissension among the recipients. However, it seems very doubtful whether they definitely create good-will and stimulate initiative unless they are given out by a manager who knows

how to tune up his organization so that the bonus is but one step in his drive for closer supervision and a cooperative attitude. The mere handing out of money in an envelope at Christmas time has a small incentive value, and, where spent in advance, may even produce negative results. But when such bonuses are combined with the close personal contact and supervision of the chief and with a word calculated to inspire greater effort and carefulness, favorable results may be obtained. These secret, though numerous, bonuses may appear satisfactory to many of their users, but it seems doubtful whether anything can be gained by them which cannot be more successfully accomplished by a predetermined plan. Whenever bonuses are given out indiscriminately they may be classed with the antique tools of management.

Results Hoped for

To assemble in one book descriptions of extra compensation based on profits is one objective of this study. In spite of the current interest in the methods of paying executives, the available literature on this important form is extremely meager. Among the best references are two chapters in the excellent treatment of "Profit-Sharing and Stock Ownership for Employees" by James, Burritt, Dennison, Gay, and Kendall, and a few descriptions of individual plans put out recently by the American Management Association. The latter has also published, in 1928, the extremely valuable article, "Incentives for Executives" by Mr. Henry S. Dennison. But there is an immediate need for the collection of descriptive material in this field, which is increased by the awakened interest in the subject and by the natural secrecy which retards the accumulation of information. However, it is hoped that the real contribution of this study will extend beyond the mere collection of descriptive data to its analysis and interpretation. Quantitative surveys need qualitative analysis to make them of greatest

use to business executives. Thus interpretative research has an important place in management and in personnel relations. Consequently, the second objective of the study is to seek refinements in method that may help to improve the technique. In addition, it is desired to test both the value of managerial profit-sharing as a form of extra compensation, and the conclusions reached regarding improvements in method. The only tests available for the conclusions in a study of this nature are the criticisms of those who have had actual experience with managerial profit-sharing, and the pragmatic test of trying out the conclusions in actual plans designed to fit given situations. As explained in the discussion of method, both of these tests have been employed.

Method

The study was approached by a survey of all the literature bearing upon the subject. The reading covered all types of profit-sharing, as well as the economic background, and the attention was focused upon the objectives and philosophy of profit-sharing, as well as on the arguments for and against it.

To collect the descriptions of existing plans falling within the restricted field of the study, an effort was first made to discover and digest all written statements describing plans, whether managerial or not. From these descriptions covering American, English, French, and German plans, a small number of leads to managerial plans were secured. The 60 American plans for the rank and file listed in the study by Boris Emmet, the 39 profit-sharing, the 30 bonus plans, and the dozen savings sharing schemes in the National Industrial Conference Board study were scrutinized. In a similar way were covered the 176 profit-sharing schemes of the United Kingdom, which are outlined in the 1920 report of the Ministry of Labour. Also the French, German, and Dutch plans for profit-sharing, described in the 1914 report

of the Ministry of Labour of Great Britain, were examined for plans that might belong to the specialized field of this study. Detailed analyses were made of 141 American plans, of which only 65 were found to lie within the limits of our definition.

After leads had been obtained in this way, the collection of data was continued by personal interview, or by questionnaire when a visit was impracticable. The questionnaire proved satisfactory only as a means of obtaining descriptions of the structure of plans. Interviews and letters were found essential for the appraisal of unusual features or refinements in method. Of the 35 plans described on the worksheets, pages 30 to 46, information regarding 31 was obtained from primary sources.

After all the leads had been exhausted, questionnaires were sent to fifteen representative companies of large or medium size to determine whether companies that were not known to have profit sharing would be a fruitful source of plans. Although replies were received from 80 per cent of these companies, no predetermined plans for executive profit-sharing were discovered. Since a complete survey was not the object of the study, and the author already had the results of a general questionnaire sent to about 3000 companies by the Industrial Relations Section of Princton University, the further attempt to collect actual plans was abandoned.

In investigating a plan, the attempt was made to find out how successful the plan was considered by the company, and whether or not alterations had been made in it. Although plans were obtained from more than sixty companies, only part of the data can be published because of their highly confidential nature. In some cases, the companies requested that nothing be revealed; in others, they were willing to have the plan discussed provided their names were not used in connection with it. Wherever possible, descriptions published by the companies themselves were secured. If no formal statements were available, the com-

panies were asked to describe their plans in a letter. The questionnaire asking for this information is shown below:

July 1, 1927

Dear Sir:

The writer is making a study of *managerial profit-sharing* for a group of Philadelphia concerns. If you have profit-sharing arrangements for your managerial group, and if the information is not too confidential to be disclosed, it would be of great assistance to us to have an outline of the structure of your plan. We are especially interested in the answers to the following questions:

1. Who shares? (Who is eligible to participate?)
2. What percentage of net earnings goes to the profit sharers, and what deductions are made before this percentage is applied?
3. On what basis is management's "pot" apportioned?
4. In what form is the payment made?
5. In what year was your plan started?

Your comments concerning results with, or desirable alterations to your plan would be particularly helpful.

Will you kindly indicate whether you desire to have the information regarded by me as absolutely confidential, or whether the structure of your plan may be described if a report of the study is published? In the latter case, may the name of your company be mentioned?

Our study is an attempt to discover what is current practice and, if possible, what is best practice in the use of managerial profit-sharing as a form of extra compensation for executives. If you have any questions regarding the study, I will be glad to answer them.

In order to test the preliminary conclusions, new plans were drawn up for three companies in which managerial profit-sharing had never been used. Also, a critical analysis was made of two existing schemes, culminating in reports to the management of those companies. These five reports, whose combined volume is about 100 pages, were of great assistance in testing out conclusions under different sets of conditions.

The preliminary conclusions also received the benefit of the criticism and discussion of a meeting of fifty executives led by Mr. Henry S. Dennison. Among those executives were a considerable number who had had practical experience with profit-sharing and were therefore in a position to aid this study by criticism and debate.

Definitions

The term "profit-sharing," as used in this study, means the sharing of net income with management on a definite basis, fixed in advance. Unless otherwise described, the term will therefore always be confined to predetermined profit-sharing with executives and managers. Because "profit-sharing" has become popular usage, it is employed here in spite of technical inaccuracy. Strictly speaking, profit is the residual share belonging to owners, and the bonus paid out under "profit-sharing" is not profit but compensation.

For a plan to be "predetermined" means that the arrangements must be definite and known in advance. Complete predetermination would cover the selection of participants, the deductions from net earnings before the fund is set aside, the percentage which is placed in the fund after these deductions, and the basis on which the fund is apportioned. Plans included here are predetermined at least in regard to deductions.

"Profit," as used in this book, means net operating income. To be more explicit, it is the gross operating profit less depreciation, interest on funded debt, and usually

Federal taxes. Expressed still differently, it is the fund available for dividends, or the increase in net worth due to business operations.

Where the word "management" appears in this study, it relates to executives, supervisory employees, and research men who are in a position to contribute to profits in an appreciable amount. We do not question the means by which a man enjoys the right to belong to that chosen class called management. Our problem begins with the managers who are now on the job. The term "management," as used by the author, refers to people in strategic positions and not to the science or the art, and the above description is in no sense an attempt to give a definition satisfactory for all purposes. Rather is it an effort to show the limits within which the term is used in this study. The author would not have readers infer that we are attempting to close the argument as to whether all management is confined to those above a certain rank, such as that of assistant foreman, or gang boss. For purposes of clarity, however, it has been necessary to confine the use of the term to those who are recognized as occupying positions that contribute appreciably to the welfare and prosperity of the enterprise.

CHAPTER I

THE PLACE OF MANAGERIAL PROFIT SHARING AS ONE FORM OF EXTRA COMPENSATION FOR EXECUTIVES

PROFIT-SHARING is by no means the only type of extra compensation for executives, and it does not offer a universal panacea. Just as the use of profits as a basis for these extra payments aims at certain specific results, so the other types are adapted to particular kinds of situations. Moreover, the use of profit-sharing for some of the executives does not prevent the use of other types of payment in the same concern.

The common types of contingent pay for the managerial group (chief executive to foreman or salesman inclusive) may be classified as follows:

1. Production (or sales) bonuses based on output of a department or of the plant as a whole. These include the familiar bonuses for maintaining or excelling production schedules or sales quotas.

2. Savings-sharing bonuses.
   (*a*) Savings in direct expense. Of this type are bonuses for increasing the efficiency of direct labor, and for reducing the waste of material.
   (*b*) Savings in overhead.
   These cover savings in indirect labor, or other overhead items that may be under the control of the manager in question.

3. Quality bonuses.

4. Profit-sharing.

Production, Savings and Quality Bonuses

When salaries are made contingent upon production, upon sales quotas, upon quality, or upon savings in expense, standards of performance are set up. The bonuses are earned only if these standards are attained or bettered. When carefully measured standards can be set, they form a basis for paying managers according to their individual performance. For those who hold executive jobs of such minor importance that they exert little direct influence on profits, this form of money incentive seems successful, provided the standards are the result of scientific study, not rule-of-thumb guesswork or mere past performance. They are especially adapted to encouraging initiative and extra effort if the factors affecting the standard are under the control of the manager in question. Their best use is limited, however, to cases where the task and results can be accurately measured, which necessitates considerable stability of conditions and independence of the influence of other branches of the business.

The type of compensation which is contingent on output and cost is illustrated by the following statement of Mr. Charles M. Schwab, in which he strongly advocates the substitution of contingent for straight salaries.[1] In discussing whether or not an annual salary of $500,000 could be honestly earned, he argued as follows:

> "Such an amount should be given only as a reward for definite operation results accomplished, manufacturing costs reduced, waste eliminated, metallurgical and other processes simplified, new and cheaper sources of raw materials discovered—in a word, for the achievement of what is expressed in that much-abused but none the less potent phrase, business efficiency.

[1] Charles M. Schwab: "The Rewards of Management," Administration, May, 1923.

"An illustration may be taken from the steel industry, in which I have spent my life. Suppose that I am about to choose and hire a man to take charge of a plant for the production of pig iron. He may feel that he should have an annual salary of $10,000 for the work, but I should much prefer to make him an offer something like this:

"'Let us make the salary not $10,000, but $3,000. In addition to that I will give you a percentage on all you save in manufacturing costs, based on an average of $1.50 a ton for putting the material into pig iron. If you cut the cost to $1.45, I will give you 1 per cent on the amount saved; if to $1.35, 2 per cent, and so on. Thus you may be able to earn for yourself not $10,000 but $25,000, $50,000, $75,000, or more. You devote yourself to cutting costs and making money for the company, and the company will play fair with you. In that way you will, in effect, determine your own salary every year.' . . . . . .

"Business and production managers who 'ain't farming as good as they know how' appear to acquire energy, enthusiasm, and ideas when they are put on a small salary with large contingent possibilities. It brings out all there is in them of resourcefulness, without which quality a business executive is a total loss with no insurance."

Another example of this type of incentive based on standards of output and cost is the arrangement of the White Sewing Machine Company, which its president describes as follows:

"The amount of premium these executives may draw through our plan has nothing to do directly with the earnings of the business as a whole, nor is it affected by failure of any other department or

division to measure up to standard except as such case might indirectly affect general production or performance.

"Our main objective is literally to hold each executive responsible for the successful operation of his department or division. By doing this we automatically cause him to become interested in what all the other departments are doing, at least to the extent that any other department's failure to perform may be reflected through interference with possible bonus or premium for his own division. Each and every one of these executives, whether he be works manager, superintendent, foreman or assistant, participates in this 25 per cent residue of the total premium based upon the production per man-hour, on the ratio of indirect to direct labor, and on the cost of all items within the control of the particular executive. In computing costs we include, of course, all repairs, re-operations, scrap, in fact, all things which have to do with cost, quality, and scheduled production.

"For computing the amount of bonus or premium due the manufacturing executives we use a table of standards accurately set (using and taking into consideration all known factors) and govern the participation accordingly. Points are awarded, scientifically based for performance over standard. These points have a definite value, dependent somewhat on the responsibility of the individual. In the case of the foremen, for example, they receive 1 cent per point for performance over standard for each hour the department is operated. The effectiveness is computed on the basis of a two weeks' average and is paid every four weeks for the period. At the present time there are approximately eighty persons in our manufacturing executives' organization participating in premiums on

this basis. Some of the foremen are receiving as much as $90 for the four-week period."[2]

Difficulties in the use of saving-sharing plans arise when changes of method or shifts of individual wage rates cause the standards to become inaccurate, for attempts to raise the standard are likely to seem like "wage cutting." Failures have also occurred because records of past performance, instead of the results of careful studies, were adopted as the labor standards. The usual result of using past performance is to penalize the departments that are so good that they cannot make easy gains, and to favor the departments with labor costs so high that they are easily excelled.

Attitudes Toward Executive Profit-Sharing

Profits are a universal unit of measurement for the work of major executives, and in most kinds of enterprises profits are the only convenient measure of the *initiative* of these men. However, the adherents of profit-sharing claim that the chief importance of using profits lies in the fact that they are an index of *willingness to cooperate*, on the part of the very high executives and of the minor executives as well. They argue that in the ordinary concern, the work of the several executives is so closely interwoven that the only possible common denominator is profits. In contrast to the steel mill superintendent, paid a salary contingent upon the savings in cost per ton, the work of many executives is dependent for success on the cooperation of others. To an increasing extent, management jobs are mutually dependent. The shift from the emphasis upon line or military relationships in industrial organizations to an emphasis on staff advice and functional control tends to break down the old independence of departments.

[2] A. S. Rodgers, President, White Sewing Machine Co., "Incentives for Executives," Production Series No. 68 of the American Management Association, pages 9 and 10.

These believers in profit-sharing for executives feel that the use of net operating profits as the basis of extra compensation for managers puts a premium upon cooperation and harmonious team work. The cost of discord has long been a subject for "pep" talks and editorials in plant publications. May not the sharing of profits, if any, with the group in which smooth team play is most needed encourage its effective cooperation? The use of profit-sharing for executives, insofar as it aims to secure this essential team play, may be likened to the use of group incentives for manual workers in departments where their jobs are linked together.

None of the types of extra pay for managers seem to reward team work quite so directly as profit-sharing. Since the work of the several executives who manage the ordinary run of medium-sized and large enterprises is closely interwoven, it is emphasized strongly that the only known common denominator for the joint contribution of all of them is profits.

Payment by performance has long been the essential feature of wage-payment systems for manual workers. Since its success in this field as a spur to greater effort and initiative has become almost a by-word, and since profits are a convenient unit of measurement, the question must be answered as to why contingent salaries are not used more widely in this country. The same question must also be answered in respect to that special type of extra compensation for managers, predetermined profit-sharing.

The causes that have delayed a more widespread use might be summarized as follows: the difficulty of setting standards of performance; the mixture of responsibilities in our modern organizations so that most executives are no longer in sole charge of a clearly defined area; and our poorly developed technique for appraising the actual work of individuals. Another cause is the inertia of the old American habit of paying straight salaries.[3]

[3] F. W. Taussig and W. S. Barker: "American Corporations and Executives," Quarterly Journal of Economics, November, 1925.

An example of the American tradition favoring straight salaries is the case of the Standard Oil Company of New Jersey. Mr. C. T. White, its secretary, explained its reasons for thus compensating executives as follows:

> "We believe that a man works best on a guaranteed salary. If we make his salary large enough to cover the risks incident to the scale of living to which he is properly entitled we get 90 or 95 or even the full 100 per cent of his time, his physical and mental energy, and his enthusiasm."[4]

The need for owners to pay their executives according to performance was seen by Professor Taussig and Mr. Barker as a result of their study of four hundred American corporations. They discovered that in the pre-war period, 1909–14, only 5 per cent of these companies had a *regular* method of extra compensation and the total which gave extra rewards to executives in any form was only 13 per cent. This adherence to fixed salaries caused Professor Taussig and Mr. Barker to raise the following question:

> "And yet, when all is said of the good sides of this 'American plan,' is it not worth while to consider whether even better results might not be attained if there were more direct connection between executive earnings and executive success? . . . Most of all may the question be raised concerning the corporations of our *B* and *C* groups,—those not very large and not very small. They are often not at all close corporations. Often they do not show that community of interest between executives and owners which comes when the executives are themselves large holders of stock. They cannot command the services of the outstanding business leaders, the rare few who have an unquestionable genius for organization and management. They

[4] C. T. White: "Salaries for Executives," Administration, June, 1923.

must be content with intelligent, solid, prudent executives, who in the main follow those in the foremost rank. Might they not follow faster, be more on their toes, if there were a clear, immediate relation between their earnings and the net earnings of their concern?"[5]

[5] F. W. Taussig and W. S. Barker: "American Corporations and Executives," Quarterly Journal of Economics (Harvard University Press), Vol. XL, November, 1925, page 51.

CHAPTER II

EVIDENCE THAT MANAGERIAL PROFIT SHARING IS EFFECTIVE

The worth of managerial profit-sharing as a method of compensation cannot be proven statistically. Comparisons of profits, sales volume, and labor turnover before and after the installation of a given plan are almost useless, because these figures are affected by so many factors other than the one we are examining. We cannot compare the figures of the same company for the same year *with* and *without* this spur to exceptional performance.

We are limited to two sources of evidence. The first is the mortality rate of plans which have been started. If plans which are initiated continue in existence for at least five years, that fact would seem to indicate that neither owners nor managers are dissatisfied. The character of this evidence is negative, not positive.

The second source is to examine the testimony of high executives who have had experience with managerial profit-sharing. As evidence, these opinions are less conclusive than numerical facts, but they are an expression of the considered judgment of men in a position to view the results of various plans. Even if we make allowance for possible bias on the part of these executives, their testimony, if favorable, would seem sufficiently convincing to warrant a detailed study of the best methods to employ.

Small Number of Failures

In contrast to the high mortality rate of plans for the rank and file, the death list for managerial profit-sharing is

surprisingly small. The author has information concerning 65 plans for sharing earnings with executives (with 15 additional borderline cases), and of this number only 4 have been reported as unsatisfactory. Among the reasons given for discontinuance were too many participants who did not realize their influence on profits, and distribution on a salary basis which did not reflect individual effort. The total number of plans which have been started and are not now in operation is 9, or 14 per cent of the total, but of this number 5 were discontinued or altered because of financial reorganization or lack of profits. Perhaps allowance should be made for the fact that since schemes for the rank and file receive much more publicity than those for management, the failures of the former are more certain to receive publicity. Even so, a record of only 4 failures out of 65 attempts or 6 per cent of the total, offers convincing evidence.

The year of starting is available for 32 plans, and for these the average duration to date is 10.7 years. The number of plans of each age is shown by the table below.

TABLE I

AGES OF MANAGERIAL PROFIT-SHARING PLANS

Age, Years	Number of Plans	Per Cent of Total	Number of Plans Revised
Under 5.....	1	3.0	1
5 and under 6.....	7	22.0	1
6 " " 7.....	3	9.5	1
7 " " 8.....	2	6.0	....
8 " " 9.....	4	12.5	1*
9 " " 10.....	1	3.0	1
10 " " 15.....	7	22.0	2
15 " " 20.....	3	9.5	....
20 and over.....	4	12.5	1
Total.....	32	100.0	8

* Discontinued.

In the foregoing table the plans are dated from the year in which managerial profit-sharing was started, if the company still has a managerial profit-sharing arrangement. The revised plans date from the initiation of the original plan and not from the date of the revision. In one case, however, where a plan was abandoned in 1919, and another begun in 1923, the plan has been dated from 1923. The revised plans have been treated as continuations of their predecessors because it is felt that many plans which have not undergone a "revision" have experienced minor changes which might have been called "revisions."

TABLE II

Ages of Profit-sharing Schemes for Rank and File in Great Britain *

Age, Years	Abandoned Plans		Surviving Plans	
	Number	Per Cent of Total	Number	Per Cent of Total
Under 5.....	76	41	17	11
5 and under 11	52	28	66	43
11 and under 16	26	14	26	17
16 and under 21	14	8	10	7
21 and over....	16	9	34	22
Total.....	184	100	153†	100

* Tabulated from Ministry of Labour (Intelligence and Statistics Department): Report on Profit-Sharing and Labour Co-Partnership in the United Kingdom (1920), page 14.
† Does not include 29 plans begun in 1919.

The low mortality of managerial plans is all the more striking in comparison with schemes for the rank and file. Since the data for plans started in Great Britain are more complete than for those in the United States, the former will be used to indicate the duration of profit-sharing for manual workers. Of the 380 schemes initiated in Great Britain in the ninety-year period, 1829 to 1919, 182 were

alive in 1919 and 198 had ceased to exist. Of 177 plans abandoned, 19 ceased to exist because of the dissatisfaction of employer or employee. On account of the many changes in an enterprise during a ninety-year interval, the fact that nearly 50 per cent of the plans had been abandoned is without significance. However, Table II, which shows the

TABLE III

SURVIVAL OF PROFIT-SHARING SCHEMES FOR THE RANK AND FILE IN GREAT BRITAIN * (1829 to October, 1919)

Nature of Business	Number Started	Number Abandoned	Number Surviving
Agriculture	23	15	8
Building trades	14	11	3
Chemicals, soap and candles, oil, paint and varnish; brick, lime, pottery and glass	22	9	13
Clothing trades	16	11	5
Electrical concerns	2	.....	2
Food and drink (manufacture)	34	18	16
Gas companies	40	4	36
Metal trades	13	8	5
Engineering and shipbuilding	31	17	14
Mining and quarrying	6	5	1
Paper making	6	2	4
Printing, bookbinding, and stationery	38	25	13
Textile trades	25	8	17
Transportation	4	2	2
Woodworking and furnishing trades	10	9	1
Warehouses, wholesale and retail houses	58	33	25
Banking, insurance and other financial enterprises	5	.....	5
Other types of business	33	21	12
Total	380	198	182

*Adapted from Ministry of Labour (Intelligence and Statistics Department): Report on Profit-Sharing and Labour Co-Partnership in the United Kingdom, page 15.

duration of abandoned and surviving plans, indicates that 41 per cent of the abandoned plans were less than five years old, 69 per cent were less than eleven years old, and 83 per cent were less than sixteen years old. About 20 per cent of all the schemes that were started lasted less than five years, and about 35 per cent lasted less than eleven years. The average life of all the abandoned plans was eight and one-half years, and of the existing plans fourteen years.

The distribution of these plans by industries is shown by Table III, page 21.

Opinions of Executives

Executives who have had actual experience with predetermined profit-sharing testify that the results are satisfactory. Mr. C. S. Carpenter, Vice-President in charge of finances of E. I. Du Pont de Nemours & Co. writes, "This plan has been in operation for but a relatively short period, but we feel very well satisfied with it."

Mr. R. J. Frackleton, President of the Chandler & Price Company, Cleveland, Ohio, manufacturers of printing presses, states: "The plan has been working for approximately six years. The results have been very satisfactory as the *group are united*, working together, interested in the business and extremely loyal. My own judgment has been that the plan has not been at the expense of the stockholders but rather to their advantage."

The president of another large company, which has shared profits with executives for nineteen years writes, "We consider the plan of paying executives in part contingent upon the profits of the company to be very helpful and constructive. Not only does it give an added stimulus to executives to put forth their best efforts, but also has the important advantage of bringing about an automatic reduction in expenses during years, when, for any reason, the profits of the company are below normal."

Mr. Morris E. Leeds, President of the Leeds & Northrup

Company, Inc., Philadelphia, which makes electrical instruments, says:

> "So far as we are able to judge, the bonus plan is working satisfactorily. It has been in operation too short a time for us to draw conclusions with confidence. Since its inauguration the company's business and profits have increased and we are inclined to give the plan credit for a considerable part of this satisfactory growth; but we must remember that we have been going through a relatively prosperous period and that the real test will come in times of business depression.
>
> "We feel that the bonus plan has brought about a greater degree of mutual understanding and respect in our organization, and that its appeal to the sense of justice and fair play has definitely stimulated the recipients, both as individuals and as a group, to better work and greater loyalty."[1]

Mr. Malcolm McIntyre, Vice-President of Bergen Point Iron Works, reports that their plan, which has been in existence since 1918, is "fine as is."

Mr. John J. Raskob, Chairman of the Finance Committee of the General Motors Corporation, makes the following comment concerning the place of a financial incentive in the development of an organization and the results obtained by the bonus plan of his Corporation:

> "The far-sighted ironmaster, Carnegie, was among the first of the organizers of a corporation in a world-wide trade to recognize that there was a limit to the inducement offered by salary. . . . He was able to show them (his partners) that they could profit more certainly and extensively as his partners than in any other way.
>
> "I hold this to be a sound principle of organiza-

[1] M. E. Leeds, "Incentives for Executives," Production Series No. 68 of the American Management Association, 20 Vesey Street, New York, page 9.

tion, but I would go further. In a corporation like General Motors, owned by 50,000 stockholders, the opportunity to profit by the prosperity of the business should be extended to every member of the organization according to the importance of the part he plays in producing effective results. This is exactly what General Motors is doing.

* * * * * *

"The bonus plan, therefore, provides an incentive to best effort by principal employees whose further reward lies in advancement to higher and still more important positions in the Corporation. Conversely, the Corporation profits by its ability to fill these positions with men whose managerial ability has been amply demonstrated."[2]

Mr. H. W. Deyo, Secretary and Asst. Treasurer of the F. W. Woolworth Company, writes: "We are pleased to state that the profit-sharing system was introduced by the founders of our company when they first entered the 5 and 10 cent business, and the results were so satisfactory, it has always been continued."

Mr. Charles E. Mitchell, President of the National City Company, points out that if a corporation is to sell securities in competition with partnerships, its key men must be financially interested in its profits.

These are samples of the opinions of executives who are in positions where they can judge the results of profit-sharing for management.

Since the effectiveness of any financial incentive is restricted if the basis of payment is affected by factors beyond the control of the employee, it is important to consider whether managerial profit-sharing is applicable to industries where profits depend greatly on speculative buying. For example, in the manufacture of certain leather

[2] John J. Raskob: "Management: the Major Factor in All Industry," Industrial Management, September, 1927, pages 192–195.

goods, about 75 per cent of the manufacturing cost is raw material, and in a single year the price of hides has fluctuated 40 per cent. In such a business, a shift of prices may influence net profits more than internal economies. Such an enterprise involves not only manufacturing but trading.

Is managerial profit-sharing suitable for these speculative industries where profits tend to be unstable? Insofar as the executives feel that the profits of any year are beyond their control, and that they are the result of the cyclical movements of general business rather than of good management within, the sharing of profits loses its effectiveness as a spur to greater initiative. Furthermore, a plan to share profits is likely to operate less smoothly if profits are unstable than if they are stable, because the chance of disappointment is greater. In the judgment of the author, however, it is worth while to give executives a stake in profits no matter how speculative the business may be.

Evidence to support this opinion may be drawn from the long use of profit-sharing for fishing vessels. Although the shares go to rank-and-file fishermen, the small size of the crews and the close relation of the work of each man to the "haul" makes this use of profit-sharing akin to its use for managers. Mr. Gorton James and his co-authors describe the general use of profit-sharing in this industry in the following terms:

> "The American fishing industry was conducted on a profit-sharing basis from its beginning until recently. Within the last few years the demand for guaranteed pay has been made effective as the trade has become unionized. But this is the only industry, as far as records show, in which profit-sharing has ever been in general use." [3]

When criticising the conclusions of the writer, Mr. Henry S. Dennison made the following comment:

[3] James, Dennison, Gay, Kendall, and Burritt: "Profit Sharing and Stock Ownership for Employees" (Harper), 1926, page 9.

> "I believe conditions of moderate instability and irregularity of profits are not incompatible with managerial profit-sharing. Such fluctuations as we have experienced in our own relatively stable business have given us grounds to believe that a managerial profit-sharing plan, if properly managed, should be as effective in an irregular business as in a steady one. The bad effects of years of low profits or even of losses have been unduly emphasized in such writings on managerial profit-sharing as have been done. They have favorable possibilities of stimulation which have usually been overlooked." [4]

To summarize, we may conclude, from the small number of failures and the testimony of executives who have observed the results of actual plans, that managerial profit-sharing is a valuable device. It seems evident that for the average concern the most satisfactory measure of managerial team work is net profits. For major executives, profit-sharing is a means of making the reward proportionate to the cooperative effort, and for groups including minor executives it appears to be the logical form of extra compensation to secure harmony and effective cooperation. Although managerial profit-sharing seems to work most smoothly in stable concerns, it also has a place in enterprises where profits are speculative and fluctuate. The difficulties which have delayed the more widespread use of contingent salaries in this country also block the adoption of managerial profit-sharing. The chief obstacles are the difficulty of setting a fair standard to be reached and our imperfect methods of measuring the contributions of individual managers. The latter difficulty is increased by the inter-relationship of jobs in many modern organizations.

[4] President of the Dennison Manufacturing Company, Framingham, Mass., and co-author of "Profit Sharing, Its Principles and Practice" (1918) and of "Profit Sharing and Stock Ownership for Employees" (1926).

CHAPTER III

FORM OR STRUCTURE OF ACTUAL PLANS

ALTHOUGH the mere description of "what is" is not a sure guide to what is best, the analysis of plans which have been put into practice is not only stimulating because of the original ideas disclosed, but also forms a background for our analysis. It is the purpose of this chapter to describe the external form and structure of a number of plans for sharing profits with executives in the hope that this will form a background from which conclusions may be drawn as to what is the best procedure. The cross-section of current practice presented here is not without bias for our sampling is affected by the willingness of companies to reveal their arrangements. But since our focus is upon improvements in method, the bias has no significance.

The material for this chapter has been derived from many sources, chief of which are interviews with owners and executives of companies that have plans in operation, letters from executives in response to a questionnaire, and published articles. The group of plans selected for our study constitutes but a small portion of the total number of so-called profit-sharing schemes. It does not cover all of those which have been published, for the major part of profit-sharing literature deals with plans for the rank and file. To be known as a profit-sharing concern has been considered by certain companies to be good advertising, and consequently descriptions of several hundred schemes, adopted in Europe, England, and the United States, are available. Likewise, publicity is an essential part of stock-purchase plans for employees.

In contrast, the compensation of executives is regarded as a confidential matter by many concerns and consequently the literature on *managerial* profit-sharing is not abundant. The same desire for secrecy which has tended to prevent the open discussion of plans involving executives permits the publishing of only about one-half the data which have been collected during this study.

An Analysis of Typical Plans

In presenting a picture of current practice in relation to our topic, we are faced with two problems: the sorting of "managerial" plans from the many varieties of profit-sharing arrangements; and the analysis of the structures of managerial plans into comparable divisions.

The first of these problems is the more difficult. The sorting process turns on the distinction between true profit-sharing schemes and those involving stock ownership, savings-sharing, and informal bonuses; and also on the determination of the positions in the concern held by those eligible to share. Managerial titles mean so little that it has been difficult to make a clear-cut selection. Even where it has been possible to secure descriptions of the jobs, we cannot always determine with certainty whether or not they allow an appreciable contribution to management. The difficulties that have blocked any general progress toward solving the problems of "who manages, and how much," make our selection somewhat rough.

The following basis was used in selecting plans for this analysis:

1. That the plan meet our definition of managerial profit-sharing.
2. That the participants be confined to management (including principal salaried employees) or that the managerial group share on a different basis from manual workers.

The plans selected have been predetermined at least in respect to the relation of management's fund to possible earnings. In some cases, those who participate and the share of each in the fund are not known in advance of the distribution. For a manufacturing business, management might be roughly described as including all employees above the rank of assistant-foreman or gang boss. Cases of profit-sharing for management in which profits were also shared with the rank and file were included only if management shared on a different basis from the workers. If the profits were distributed among all employees, irrespective of position, in equal amounts or in the same proportion to salary, the plan was not included. Certain schemes in which participation is granted to all salaried employees, as distinguished from wage-earners, have been admitted. Plans which base their eligibility on the payment of salary above a given minimum have also been included because of the close similarity between their aim and that of the plans just described. The last two groups of companies are distinctly on the borderline, and doubtless many receive a share of profits in these companies who, strictly speaking, do not belong to management. However, the aim of these companies is to share profits with their executives and chief employees, and for the purpose of our study much is gained by classifying their plans as managerial profit-sharing.

In order to make the data as comparable as possible, the structure of each plan has been divided into four parts. The dissection of these plans seems to be necessary on account of the wealth of detail which is involved. The parts which have been treated independently are as follows:

1. The eligibility to participate.
2. The method of determining the share of profits allotted to management.
3. The apportionment of that share among those selected to participate.
4. The form of payment or manner in which the distribution is made.

TABLE IV

STRUCTURE OF TYPICAL MANAGERIAL PROFIT-SHARING PLANS

A Name and Address of Concern	B Who Are Eligible to Participate?	C Basis of Determining Size of Management's Fund	D Basis of Apportioning Management's Fund	E Form of Payment
1. The American Rolling Mill Co., Middletown, Ohio.	All employees, other than officers, who are paid a monthly salary and have been in continuous service one year. Divided into 3 groups: 1. "Special partners": heads of divisions, their assistants, and heads of principal departments. 2. "Some assistants and heads of other departments." 3. All other eligible salaried employees.	A percentage of net profit is set aside for a "Special Compensation Fund." Two-thirds of "Fund" allotted to Group 1. Remainder to Group 2 and 3.	To Group 1: Apportionment "by the management, as in their judgment seems equitable." To Group 2 and 3 on salary basis plus 10 per cent for each year of service up to ten. Each participant in Group 2 receives 3 times as much as a participant in Group 3.	Not less than 50 per cent in cash, usually in May following end of fiscal year. Remainder held in reserve for cash distribution over period not exceeding three years.
2. Bemis Bros. Bag Co., Boston, Mass.	Officers, managers, department heads, superintendents, all salesmen; clerks and operating foremen whose annual salaries equal $1800.	After 5 per cent of invested capital, one-third of earnings up to 10 per cent of capital, and 15 per cent of excess over 10 per cent of capital.	Annual salary (actual income).	Cash, annually, 60 days after close of fiscal year.

3. Bergen Point Iron Works, Bayonne, N. J.	Superintendents, Chief Engineer, Manager, Sales Manager, Cashier, Secretary, Treasurer, Vice-President, and President.	After a percentage on common stock, one-third of remainder to managerial group. *Note:* one-third goes to stockholders; one-third to office, drafting room, and shop.	Salary.	Cash.
4. The Chandler and Price Co. (printing presses and machinery), Cleveland, Ohio.	Executives (except President) down to foremen and sub-foremen. (About 12 per cent of total employees).	After 5 per cent of net earnings to stockholders, a percentage on salaries is paid, equal to percentage of dividend on common stock.	Salary.	Cash (checks) at Christmas.
5. Dennison Mfg. Co., Inc. (tags, boxes, paper specialties), Framingham, Mass. "Managerial Industrial Partnership" Plan.	Directors, sales managers, department heads, superintendents, principal foremen, chief clerks, senior salesmen with 5 years' service. Selected by Board of Directors, composed of executives "who are all Dennison men."	After 8 per cent on preferred, 7 per cent on 2d preferred, 5 per cent depreciation, and 5 per cent for calling 1st preferred, one-half of remainder to dividend on common at rate decided by Board of Directors. Remaining one-half reinvested and Industrial Partnership Stock issued against it. Two-thirds of this stock allotted to management, one-third to rank and file.	Salary.	Common stock, annually. This "M.I.P." stock pays variable dividends, has voting power, but is non-transferable. At death or separation must be exchanged for 7 per cent 2d preferred of "equal par value."

TABLE IV—*Continued*

A Name and Address of Concern	B Who Are Eligible to Participate?	C Basis of Determining Size of Management's Fund	D Basis of Apportioning Management's Fund	E Form of Payment
6. E. I. du Pont de Nemours & Co., Wilmington, Del.	Officers and management above rank of foremen to be selected by Bonus Committee of three members of Board of Directors upon recommendation of Executive Committee. Selection of participant who is a member of Board of Directors requires recommendation of President and approval of 4 directors who do not participate.	Funds for "merit bonuses" to be derived from two sources: 1. One-half of fund available for Class *B* bonus. 2. After 6 per cent on investment, 6 per cent of net earnings from activities under control of Executive Committee.	Performance as judged by department heads, and Executive Committee with approval of Bonus Committee.	Credited to "Trust Fund," to be applied against employees' indebtedness (notes) for purchase of stock. Employee receives cash payments on fifteenth day of March, June, September, and December, interest at rate of 5 per cent per annum on total amount to his credit in Trust Fund.
7. Electric Hose and Rubber Co. (braided hose), Wilmington, Del. (400 employees).	All salaried employees.	After 10 per cent of capital stock (not including surplus) has been deducted from profits and 25 per cent of the remaining profits deducted for	At discretion of President.	Cash, annually.

		profit-sharing with employees, 25 per cent of the then remaining profits is set aside for profit-sharing with customers.		
8. General Motors Corporation, New York. Managers Securities Plan.	In Managers Securities Company: senior executives, and junior executives occupying positions of responsibility and importance (about 80 in number).	After 7 per cent on invested capital, 5 per cent to Managers Securities Company and 5 per cent to Bonus Plan.	Executives in Managers Securities Company had privilege of purchasing its stock in amounts varying with their individual responsibility.	
9. General Motors Corporation, New York. Bonus Plan.	In Bonus Plan: Other junior executives with salaries of $5000 and over who are not in Managers Securities Company. This group includes department heads and other salaried employees who hold important but directed jobs.		In Bonus Plan, distribution of fund among divisions is according to contribution of each to prosperity of company. Distribution within an operation (or division) is on basis of individual contribution according to judgment of chief (manager) of that division. His judgment is subject to the review of the Finance Committee.	Bonus Plan: Payments in common stock, one-quarter first year, and one-quarter each year for next 3 years.

TABLE IV—*Continued*

A Name and Address of Concern	B Who Are Eligible to Participate?	C Basis of Determining Size of Management's Fund	D Basis of Apportioning Management's Fund	E Form of Payment
10. Halle Bros. (Dept. store; plan discontinued), Cleveland, Ohio.	Chief officials.	Excess net profit over fixed minimum and percentage of increased sales.	Showing of individual "unit."	Cash.
11. Joya Etablissements. (Turbines, conduits), Grenoble, France. (400 employees).	Managers, technicians, various office departments and foremen.	After deducting percentage on capital 1 per cent higher than discount rate of Bank of France, one-third of remainder to management, one-third to labor, and one-third to capital.	80 per cent pro-rated on wages. 10 per cent pro-rated on service. 10 per cent pro-rated on size of family.	Cash (?)
12. The Leeds and Northrup Co. (Electrical instruments), Philadelphia, Pa. (About 600 employees).	Chief executives, factory management, and salesmen (large part of sales force.) Additions to or changes in participating groups recom-	After 8 per cent interest on preferred, and 6 per cent on present value of common (as determined from earnings by formula), remainder split	Bonus of higher sub-groups is larger, both absolutely and relatively, than bonus of lower sub-groups. Total of salaries in each of the	Cash, annually, but stock may be substituted at discretion of Company.

	mended by group members subject to approval of Executive Committee. Basis of selection equals ability to increase fund through increased effort and initiative.	empirically between common stock and management groups. Progress to date is reported to each participant monthly.	six sub-groups is multiplied by a factor to determine share of that sub-group in the fund. Factor for highest group equals 12 times that of smallest. Within a sub-group, division is on basis of salary.	
13. Lewis Manufacturing Co. (Cotton goods, part of Kendall Mills), Walpole, Mass.	A group of executives holding positions which contribute most directly to profits and losses. This group selected before end of July by Committee of senior executives and President, ex officio.	After interest on average investment in plants, inventories, and accounts receivable, a fixed percentage of net profit, changeable at discretion of committee in charge. Changes intended to be infrequent and only a result of alterations in fundamental business conditions. Percentage fixed after careful analysis at a figure considered equitable, and high enough to yield a satisfactory bonus in average years.	Percentage of salary determined by dividing amount of fund by total salaries in profit-sharing group.	Cash, annually by March 1. Time to permit final closing of books. Recipients must be on payroll at time of distribution, unless case be exceptional.

TABLE IV—*Continued*

A Name and Address of Concern	B Who Are Eligible to Participate?	C Basis of Determining Size of Management's Fund	D Basis of Apportioning Management's Fund	E Form of Payment
14. Le Maison Leclaire, now called Laurent-Fournier et Cie (House painting and decorating), Paris, France. (1140 employees).	Two "managing partners" elected by *noyau*, or "nucleus," of 140 principal managers and workmen. This "nucleus" is in effect the managing staff. These partners each have capital in the enterprise.	After 5 per cent on capital, 15 per cent to two active partners, 35 per cent paid to mutual benefit society, and 50 per cent paid to salaried staff and workers on basis of their wages.	Salary.	Cash.
15. The Morris Plan Corporation of America, New York.	1. Elected officers. 2. Officers and employees together.	After 6 per cent of capital surplus and undivided profits is deducted, 12 per cent of remainder (if less than $400,000) allotted to the fund. Of this fund 10 per cent distributed to officers (Group 1); 90 per cent goes to officers and employees together. "Net income" equals gross income (discounts	To elected officers, 10 per cent of fund at discretion of President. Balance to officers and employees at a percentage of salary according to length of service.	Cash.

		collected plus fees and charges plus interest on investments and bank balances plus commissions plus profit on sale of securities) less operating expense and other charges (salaries plus rent and other expenses plus interest on investment certificates plus reserve for losses plus overs and shorts.) If, in any year, figure after deducting is greater than $400,000, 10 per cent of excess is added to fund.	SERVICE, YEARS / PERCENTAGE OF SALARY 1 — 4 2 — 7½ 3 — 9 4 — 10½ 5 — 11¼ 6 — 12 7 — 12¾ 8 — 13½ 9 — 14¼ 10 — 15 90 per cent of the fund is pro-rated according to table above.	
16. Roos Bros. (Stores outfitting men, women, and children), San Francisco, Oakland, Berkley, Fresno, Palo Alto, Cal.	Store managers, buyers, and department heads. (This plan now altered).	Fixed percentage of net earnings. 50 per cent of this fund is for buyers and department heads.	Non-selling departments share on basis of economy of operation in their particular department. Buyers participate in earnings of all stores. Department heads share only in earnings of their own store.	Certificates of deposit in savings fund.

TABLE IV—*Continued*

A Name and Address of Concern	B Who Are Eligible to Participate?	C Basis of Determining Size of Management's Fund	D Basis of Apportioning Management's Fund	E Form of Payment
17. Sonora Phonograph Company, Inc., Saginaw, Wis. (Old plan).	All salaried employees, receiving over $2400, who received no other bonus.	10 per cent of net profit allotted to fund.	Salary.	Cash.
18. Revised plan (Drafted, but not adopted).	Group *A*: Executives above $6500; men who originate and execute policies. Group *B*: Those who assist in execution of policies and whose salaries are from $2080 to $6500.	After 10 per cent of net profit to stockholders, remainder split so that absolute return to capital increased faster than to participants until capital received 15 per cent return. Groups *A* and *B* share alike up to 28 per cent earnings, but thereafter Group *A* receives a larger share than Group *B*.	Split between Groups *A* and *B*.	
19. Walworth Company (Pipe fittings, etc.), Boston, Mass.	*A*: General office bonus. Major executives and principal assistants.	*A*: After bond interest, and preferred dividends, reserves, and 10 per cent	*A*: Share of major executives (general office bonus) is recommended	*A*: Cash.

(6500 employees).	*B*: Works bonuses—Works manager and minor executives down to straw bosses. *C*: Branch bonuses—Branch manager and principal assistants.	earned on capital, a percentage (not fixed, but has been 10 per cent) is voted for major executives. *B*: Works bonus—Percentage of net profit of that plant, providing such net profits are at least . . . per cent of capital invested in that plant. *C*: Branch bonus—Based one-half on "unit" and one-half on general profits of company. Net total of, or difference between, branch's own net profit or loss and 4 per cent of net profits of Walworth Co. (exclusive of profits of selling units.)	by President to sub-committee of Board of Directors. *B*: Works bonus—Split by works managers either by judgment alone or by formula. *C*: Branch bonus—Bonuses allotted to branch based on ratio of branch's sales to total company sales of Walworth product. Split by branch managers.	*B*: 50 per cent of bonus earned each quarter payable at end of quarter, remainder at end of year after closing of books. *C*: Cash.
20. Charles Warner Company (Lime, sand, and gravel), Wilmington, Del.	1. Management. 2. About one hundred principal employees.	After 7 per cent on capital, a percentage of remainder to "Additional Service Fund." Part of latter to executives, and part to employees.	Executives share on basis of salary. Employees share on basis of salary, service, and efficiency.	To executives, cash. To employees, common stock of the corporation bought on open market.

TABLE IV—*Continued*

A Name and Address of Concern	B Who Are Eligible to Participate?	C Basis of Determining Size of Management's Fund	D Basis of Apportioning Management's Fund	E Form of Payment
21. F. W. Woolworth Co. (5 and 10 cent stores), New York.	Store managers, and all of District Office and Executive Office Employees (including active officers).	To general executives, a percentage of profits of whole business. To district men, a percentage of total net profits of their group.		
22. C. G. Conn, Ltd. (Musical instruments), Elkhart, Ind. (Plan started in 1919, discontinued in 1927).	Class 1: Executives and chief officials. Class 2: Foremen and heads of departments who hold responsible positions or direct others. To be eligible must hold at least one share of preferred. (*Note:* General p. s. for rank and file).	After dividends on preferred, and 6 per cent on common plus surplus at first of year, and wage dividend of one-quarter to full dividend rate on common, 10 per cent to Class 1, and 10 per cent to Class 2.	Salary (the percentage of individual's salary to total of his class).	Cash, or one-half cash and one-half preferred stock at option of Directors. Payments on March 1 or soon thereafter.
23. Foundry. (Name confidential).	Officers, executives, and foremen.	After 5 per cent of book value, certain percentage	Salary, with exception of 3 principal executives.	Cash.

		of net earnings to fund.		
24. Large company making food products. (Plan about 10 years old).	All in managerial capacity. Managers and assistant managers of branch offices; department heads, sub-department heads; superintendents; assistant superintendents, principal foremen, chemists, and few important employees not heads of departments.	After 7 per cent on preferred, and "reasonable" dividend on common, 15 per cent of earnings to profit-sharing. If earnings exceed one million, percentage to profit-sharing group is reduced.	Arbitrary: fixed by committee acting on recommendations regarding service rendered.	Cash, annually (at end of calendar year).
25. Chemical Company (Plan about 20 years old).	Officers.	Before dividends, a fixed percentage of earnings (considered as part of cost of management).		Cash.
26. Steel Company. (Plan about 20 years old).	President, Vice Presidents, General Superintendents, Assistant General Superintendents, Purchasing Agent, Sales Manager, Advertising Manager.	After 7 per cent on capital stock, 12 per cent of net profit to officers and executives.	Arbitrary judgment of value of executive's judgment. Individual shares vary from 3 per cent of net earnings (after 7 per cent on capital stock) to one-quarter per cent.	Cash, annually (at end of fiscal year).

TABLE IV—*Continued*

A Name and Address of Concern	B Who Are Eligible to Participate?	C Basis of Determining Size of Management's Fund	D Basis of Apportioning Management's Fund	E Form of Payment
27. Above Steel Co. (Revision under consideration).	All executives and department heads, including foremen.	After 7 per cent, 15 or 15½ per cent to fund (includes an additional 3 or 3½ per cent for group of minor executives).	Distribution to minor executives based on salary.	
28. A distributor of electric supplies (Gen. dept. plan 5 years old, house plan 15 years old).	*A*: General Department Plan. Major executives and principal assistants (40 to 50 in number)	*A*: After 8 per cent on investment, a percentage of remainder.	*A*: According to performance.	Cash, annually on April 1st, if employee is still on payroll.
(2000 employees, of which 800 share in plans *A*, *B* or *C* [not included here]).	*B*: House Plan: (Distributing houses). General Manager, Sales Manager, Service Manager, Credit Manager.	*B*: After 8 per cent of investment in house, percentage of its net profits is distributed. Results are made known monthly.	*B*: By Bonus Committee on basis of individual performance.	

29. Rowntree & Co., Ltd. (Chocolate manufacturers), York, England. (About 8000 employees).	Directors. (Plan is designed chiefly for rank and file).	After labor receives agreed wage, 7½ per cent on capital (issued shares plus reserves and reinvested profits to Dec., 1922) and after certain reserves (dividend equalization, advertising, and contingencies) remainder split 10 per cent to directors, 50 per cent to labor and 40 per cent to capital.		Cash.
30. National Cash Register Co.,* Dayton, Ohio. (1924 plan [now altered on account of refinancing]).	Group *A*: Major executives, not including owners. Group *B*: Foremen. Group *C*: Job foremen and others holding similar positions. *Note:* Rank and file also participated.	After 6 per cent on money invested, and sinking fund of 4 per cent on money invested, 17 per cent allotted to management.	Fund of 17 per cent split: 8 per cent to Group *A*. 3 per cent to Group *B*. 6 per cent to Group *C*. Within group, division in proportion to wages or salary received.	Cash.

* Daniel Bloomfield, Financial Incentives for Employees and Executives (1923), Vol. II: page 101 (H. W. Wilsen Co.).

TABLE IV—*Continued*

A Name and Address of Concern	B Who Are Eligible to Participate?	C Basis of Determining Size of Management's Fund	D Basis of Apportioning Management's Fund	E Form of Payment
31. Guaranty Trust Company,* New York. (This plan, which included rank and file, was started in 1919 and abandoned in 1926).	1. Senior officers chiefly responsible for the production of business and the conservation and management of the company. Chairman of Board, President, Vice-President, Comptroller, Treasurer, Secretary, Managers and Assistant Managers of Foreign Branches. 2. Other officers. Both groups designated by Board of Directors at beginning of year.	After taxes, interest, and other charges, all losses, depreciation, charge-offs, and reserves (but not dividends) are deducted from gross earnings and credits, and after 3½ per cent of this "net" to employees' fund, and after 10 per cent of money invested in company is earned for stockholders, one-fifth of remainder to management. 40 per cent of fund to senior officers. 20 per cent to "other officers." 40 per cent to rank and file.	Senior officers: one-half of fund pro-rated, one-half according to judgment of Board of Directors. "Other officers": Two-thirds of fund pro-rated, one-third distributed by Board of Directors according to merit.	Cash to officers on payroll at end of year whose work has been satisfactory.
32. Manufacturer of railway equipment.	Works Manager; shop superintendents; depart-	After 7 per cent on preferred, a percentage of re-	Salary.	Cash about Feb. 1st.

	ment chiefs, such as Purchasing Agent and Chief Accountant; Sales Manager and outside salesmen. President is not included. Number of participants about 60. Participants are divided into 2 groups: *A*: General, those whose duties have to do with total results of the corporation. *B*: Those identified with specific plants.	maining earnings, except from outside investments, is placed in the fund. *A*: General fund equals 8 per cent of remainder. *B*: Fund for participants identified particularly with specific plants equals 3½ per cent. Above percentages are result of factors computed in original plan at beginning of each year.		
33. Company manufacturing roofing and bituminous products.	All officers and salaried employees, paid on a weekly or monthly basis, who receive $60 or more per month, and have been continuously employed 1 year. Leaves of absence not exceeding 3 months in any one year do not affect participation.	After $652,705 (the amount of annual dividend on preferred at time extra compensation plan was made effective), 1 per cent is paid on salary of each participant for each $100,000 of net gain to surplus.	Salary.	Cash. Payment not made if participant has resigned or been dispensed with prior to date of actual payment.

* Bloomfield, Daniel: Page 75.

TABLE IV—*Continued*

A Name and Address of Concern	B Who Are Eligible to Participate?	C Basis of Determining Size of Management's Fund	D Basis of Apportioning Management's Fund	E Form of Payment
34. The Studebaker Corporation, South Bend, Ind. (Plan first adopted 1915).	All executives, senior and junior. Includes all who have any responsibility for spending Studebaker's money, for the commitment of it to an obligation, or for the management of employees.	After 7 per cent on preferred, a special surplus account for amortization of preferred, an amount equal to $5 per share of common outstanding, and income taxes, 10 per cent of remainder to bonus fund.	According to importance of position held and contribution to profits as judged by the operating committee.	All or one-half paid in cash. If one-half is withheld, it is paid in stock, one-quarter the 1st year, one-quarter the 2nd year, and one-half the 3rd year. Participants have no right to assign stock. Payment is not made to those who have resigned or been discharged during year. Bonus of those laid off is pro-rated.
35. Yarnall-Waring Company (Valves), Philadelphia.	Office Manager, Superintendent, Cashier and Bookkeeper, Chief Draftsman, Salesmen.	After Federal taxes and 8 per cent dividends on preferred and common stock, a fixed percentage of the remainder is placed in the profit-sharing fund.	Salary, or fixed proportion fund.	Cash, annually.

The foregoing worksheets, pages 30 to 46, give digests of thirty-five plans whose details the writer is permitted to publish. In a few cases, these plans are the result of a gradual development in which alterations have been made to correct weaknesses, or to adapt them to new conditions. As is to be expected, some companies have not had profits to distribute in every year. But only two of these thirty-five plans have been discontinued or changed *so that they cannot longer be classed as managerial profit-sharing.* These are the plans of the Halle Brothers Company, a department store in Cleveland, Ohio, and of C. G. Conn, Ltd., manufacturers of musical instruments.

The Halle Brothers Company shared profits with five of the chief executives. Later these executives were permitted to acquire common stock, and profit-sharing was replaced by a stock-purchase arrangement. The reasons for the change are explained as follows:

> "In making the decision to discontinue, it was felt that men in key positions would initiate action, with respect to the policies in merchandise and expense control, with greater freedom from personal bias if the extent to which they shared in the profits did not bear as direct a relationship to the important decisions they had to make as it did when they were profit-sharers." [1]

C. G. Conn, Ltd., had a profit-sharing arrangement from 1919 to 1927, which included both management and rank and file. Class 1 comprised executives and chief officials; Class 2, foremen and heads of departments who held responsible positions or directed others; and Class 3, all other employees with one year of service who had made the required stock subscription of 1 share of 6 per cent preferred. This stock pays an extra dividend of 2 per cent to holders who are employees. The defect which has caused this

[1] James, Dennison, Gay, Kendall, and Burritt: "Profit Sharing and Stock Ownership for Employees" (Harper), 1926, page 113. This is a quotation from a letter from Jay Iglauer, Sec.-Treas., dated Sept. 4, 1925.

company to alter its plan is clearly set forth by Mr. C. D. Greenleaf, President, in a letter dated January 19, 1928:

> "The chief defect, in my opinion, in the old plan is that all of the employees in the same class receive the same percentage of bonus, regardless of the differences in efficiency. In other words, the poor man receives the same additional compensation that the good man does, based on his salary."

It is proposed to substitute an arrangement based on a comparison of actual results with set standards. The experience of this company is valuable because it points to the same weakness that other companies have found in using salaries alone as a basis of distribution.

The original plan of the Guaranty Trust Co., which included important distributions to the rank and file, was abandoned because it was costing the Company a large sum of money and was not producing the results expected from the rank-and-file employees. However, this is not an instance where *managerial* profit-sharing failed.

Tabulation of Sixty-five Managerial Profit-Sharing Plans

The tendencies that exist in the current practice of managerial profit-sharing are not readily apparent on the detailed worksheets. Consequently, the thirty-five plans which appear on the worksheets, together with thirty of the other arrangements that have been revealed in confidence, have been tabulated in Table XI which is shown in Appendix A, pages 106 to 110. In order to protect the identity of these companies, they have been given numbers which appear in the column at the left of the tabulation. The characteristics of each plan are indicated by crosses placed in the same horizontal line. The four columns at the left show the classes of executives and managers who are eligible to participate. The distinction between these classes is the degree of supervision required. Although arbitrary and somewhat

indefinite, this basis forms a common denominator by which one can roughly classify managerial jobs irrespective of title or of size of company. The next six columns show the nature of the deductions from net profits before the management participates. These columns show the deductions only, and do not give the percentage of the remainder which is placed in the fund. The next five columns portray the basis by which the management's fund is apportioned among the participants, and at the extreme right of the page five more columns indicate whether the form of payment is in cash or in stock, paid annually or deferred over a longer period.

The tendencies which are revealed by Table XI are summarized in Table V which follows on pages 49 to 51. This

TABLE V

SUMMARY OF TABULATED PLANS

I. Who Are Eligible to Participate?

	Number of Plans	Percentage of Total *
Total number of plans on which data were secured	65	100
Plans with participation limited to major executives	11	17
Plans which include major executives (Column A) in the participating group	60	92
Plans which include principal assistants or department heads (Column B)	51	78
Plans which include minor, directed executives who affect profits appreciably (Column C)	33	51
Plans which include some salaried employees (Column D)	9	14
NOTE.—This number does not include those companies with rank-and-file profit-sharing in addition to managerial.		

* Because the same plan may fall under more than one classification, the total of the percentages will not always equal 100.

TABLE V—*Continued*

SUMMARY OF TABULATED PLANS

II. Deductions from Net Earnings Before Management Shares

	Number of Plans	Percentage of Total
Total number of plans on which data were secured	64	100
Column A:		
Plans in which 5 per cent of "invested capital" (capital and surplus) is deducted	3	5
Plans in which 6 per cent of "invested capital" (capital and surplus) is deducted	7	11
Plans in which 7 per cent of "invested capital" (capital and surplus) is deducted	5	8
Plans in which 8 per cent of "invested capital" (capital and surplus) is deducted	4	6
Plans in which miscellaneous or unknown percentage of "invested capital" (capital and surplus) is deducted	8	12
Sub-total of Column *A*	27	42
Column B:		
Plans in which interest on bonds or dividends on preferred stock are deducted	16	25
Column C:		
Plans in which a fixed percentage of net earnings is deducted	4	6
Column D:		
Plans in which 6 per cent on common stock is deducted	6	9
Plans in which 7 per cent on common stock is deducted	3	5
Plans in which miscellaneous percentage on common stock is deducted	6	9
Sub-total of Column *D*	15	23
Column E:		
Plans in which there are no deductions	8	12
Miscellaneous:		
Plans in which a fixed amount is deducted or required as a minimum	4	6

TABLE V—*Continued*

SUMMARY OF TABULATED PLANS

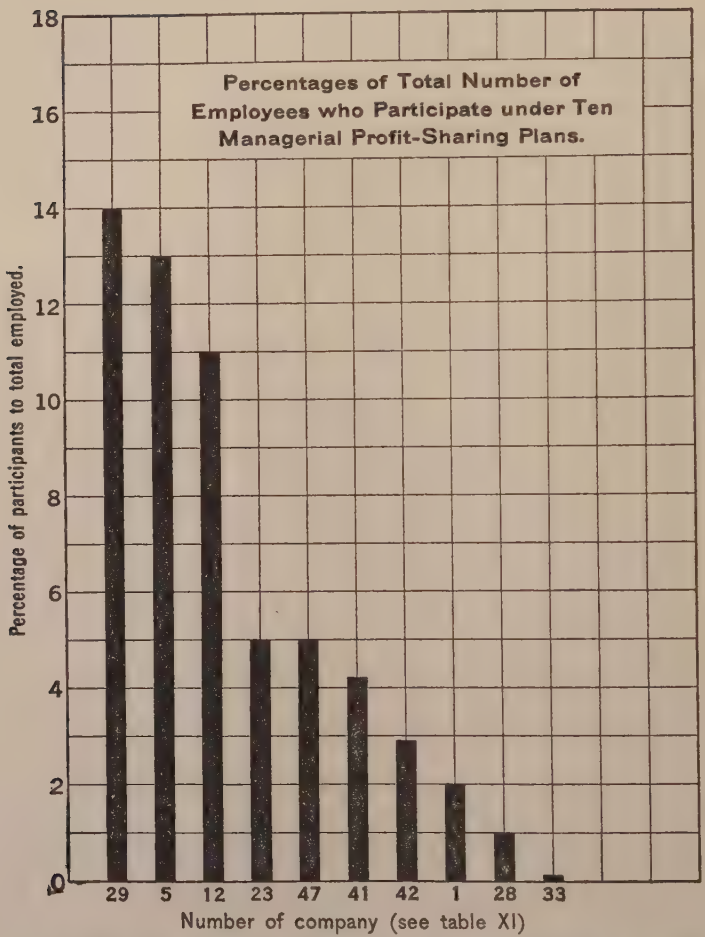
III. Basis of Apportioning Management's Fund

	Number of Plans	Percentage of Total
Total number of plans on which data were secured	62	100
Plans which base individual's share on percentage of his individual salary to total of participating group (Column *A*)	25	40
Plans which split participants into classes or subgroups and divide bonuses within group according to percentage of individual's salary to class total (Column *B*)	12	23
Plans which base distribution on individual performance (as judged by Chairman of Board, chief executive, or a committee), Column *C*	25	40
Plans which base individual share wholly or partly on service	3	5

IV. Form of Payment

	Number of Plans	Percentage of Total
Number of plans on which data were secured	61	100
Bonus paid wholly in cash, annually (Column *A*)	41	67
Bonus paid partly in cash, annually (Column *A*)	6	10
Bonus paid wholly in cash, quarterly or monthly (Column *A*)	3	5
Bonus paid partly in cash, quarterly or monthly (Column *A*)	2	3
Bonus paid in cash, but wholly or partly in deferred payments (Column *B*)	2	3
Bonus paid wholly or partly in common stock (Column *C*)	3	5
Bonus paid wholly or partly in common stock with deferred payments (Column *D*)	5	8

TABLE VI



In these ten samples, the ratio of the participants to the total number of employees varies widely. In fact, such a ratio is of little significance in determining the proper size of the participating group. Companies 12, 47, 41, and 28 have from 500 to 600 employees. All of the remainder employ more than 1000, and the payrolls of 42, 1, and 33 exceed 6000.

gives a bird's-eye view of eligibility, the deductions before participation, the distribution of the fund, and the form of payment.

From this summary, it is evident that major executives are usually included in the distribution. Principal assistants or department heads are eligible in three-fourths of the cases, and minor executives in over one-half.

The variations in the deductions made before management participates are explained by the individual differences in the financial structures of the companies. In 40 per cent of the cases a percentage of the "invested capital" was deducted. The meaning of "invested capital" in this study is not precise because it has been necessary to classify under that heading whatever a particular company designates by the phrase. Its most common meaning is capital and surplus, or capital and reinvested earnings. However, since there is no uniformity in the way in which these companies handle their reserves and intangible assets, the phrase covers a variety of meanings.

About 40 per cent of the plans determine the share which each participant is to receive according to the proportion which his individual salary is of the total salaries of the group. Another 40 per cent of the plans attempt to base the distribution on the value of individual performance. It is not implied that these companies have worked out any technique for appraising the work done by managers. It is probable that a "rule of thumb" judgment based on available records, together with what the owner or chief executive has seen or heard from others, constitutes the method followed in nearly all of these cases. It is at this point that experiment and study seem to be most needed, and consequently, in Chapter IV, the author will attempt to indicate ways in which this problem may be attacked. Twelve companies adopt the very significant compromise of first splitting their eligible group into classes according to the importance of their jobs. The total fund is first split be-

tween these sub-groups, those containing high executives receiving the largest shares. The share of each class is then allotted to each individual according to the ratio of his annual earnings to the total of his profit-sharing class.

Two-thirds of the plans distribute the bonus once a year in cash. In but a few cases has the accounting procedure made it practicable to make the payments more frequent than once a year. The fact that 67 per cent of the schemes pay in cash is no indication that this is the proper answer to the question of form of payment, which will be analyzed in the following chapter. It is worthy of note that the device of deferring payments is used by the large companies, E. I. Du Pont de Nemours & Company and General Motors Corporation. (See digests of plans, pages 32 and 33.)

It is important to point out the errors that may creep into any analysis which attempts to lift a plan out of its surroundings, or which considers one section of a plan apart from the whole. There is an obvious weakness in placing too much stress on the mere structure of a plan, and it is deceiving to examine one device of management apart from all the other devices into which it must mesh. Dissection not only kills the object studied but also prevents the observation of it as a functioning entity. To make the data intelligible, it has been necessary to separate them into four portions, but it must not be forgotten that in any plan these parts are interdependent. The number of participants may be affected by the amount of the fund, or the form of payment by the calibre of the executives.

The success or failure of profit-sharing is undoubtedly influenced more by the policy and skill of the management of the concern than it is by the mere form of the plan itself. For example, the respect which the managerial group has for the owner or chief executive is an element of profound importance in the operation of the plan, and yet no trace

of it appears in the cold description of the plan itself. It is impossible to stress too fully the importance of the "total situation," and the mere fact that this study cannot give an intimate picture of the background and setting of individual plans must place the reader constantly upon his guard lest he forget the influence of the many surrounding features. Complete information regarding the factors which helped to shape its growth is needed for a true evaluation of any one plan or of its significant features.

Influence of Intangible Elements

The extreme importance of the intangible factors which surround profit-sharing makes the "lifting," or blind copying, of a plan unwise. In fact, these intangibles should have greater influence on the design of a plan than the more easily understood points, such as size and profitableness. It is necessary to view any plan in the light of the spirit which has inspired it, because the plan is limited in its results by the attitude of the owner who initiates it. The effectiveness of any incentive depends to a great extent upon the belief of the employee, who receives it, in the honesty of purpose of the man who gives it. Consequently, if profit-sharing is used as a sop to whitewash the faulty handling of coworkers, it is not likely to prove satisfactory. If men are dissatisfied because they are underpaid, no scheme of profit-sharing, however elaborate, is likely to make them permanently loyal. It cannot be stated too often that the spirit behind profit-sharing is more important than the method.

Yet it is recognized that even an owner with the most honest intentions may fail to attain his purpose if he uses a method that is faulty. Consequently, it is important for us to further our knowledge of the best technique that men of honest intentions can use. The development of the spirit under which managerial profit-sharing will bear its richest fruit is beyond the scope of this study, for it relates to the

owner's conscience and to many influences dating back to his childhood. Neither preaching nor research is likely to change an owner's attitude and philosophy. It must not be forgotten, however, that business men of large calibre recognize that financial success in business is not incompatible with high motives, and that to an increasing extent the observance of certain ethical standards in commercial and business relations is considered "good business." The connection between this tendency and the success of managerial profit-sharing, as it is found in many large corporations, must not pass unnoted.

Honesty of purpose is not the only intangible factor that should be mentioned, however. The personality of the executive affects the ease with which he can share his problems with those around him. Although the author does not intend to belittle the real value of such arrangements as works councils in companies of considerable size, the accessibility of a chief to his co-workers is more important to the development of "management sharing" than any formal arrangement. The ability of the owner or chief executive to furnish the spark that will stir his subordinates to real active interest in the success of the business is greatly needed if the payment of bonuses is to result in more effective management. Merely to receive money will not inspire a manager to his best effort. Combined with the money payment must be the consciousness that his co-workers and his chief are looking to him for results that will justify the payment. Consequently, profit-sharing, like many other things in a business, depends for much of its success upon whether the owner or chief executive is a "spark plug" who can ignite the active loyalty of the entire group. With a leader who can constantly make the entire management feel a common purpose in an adventure which appeals to it, the sharing of profit provides a background which may contribute greatly to the growth and prosperity of the business.

Perhaps the place of the intangible factors can be shown best by describing two plans in their entirety. The two plans that have been selected to show the interdependence of the various parts, or the relationship of profit-sharing to the labor policy and to the other activities of management, are those of the Leeds & Northrup Company,[2] and of the Dennison Manufacturing Company.[3]

These plans were chosen primarily because they embody features which mark them as among the most advanced to be found anywhere, and because the author has been able to assure himself of their success in practice. Their success, however, undoubtedly reflects the excellent management in both concerns and the extreme care which has been taken in both cases to make the arrangements fair to all parties. In order that the reader may be able to see a little of the background of these two highly developed schemes, both of the plans and the settings in which they operate will be briefly outlined.

Leeds & Northrup Co., Inc.

The form and method of operation of the Leeds & Northrup plan are clearly presented in the following letter, written July 6, 1925, by Mr. Morris E. Leeds, President:

> "For a little over ten years we have had a plan by which profits, called bonuses, have been distributed to an executive group. At first this was a rather small group (five or six) and we did not have a very well-fixed method of determining the amount of profits to be distributed. Some four or five years ago the amount of the bonus fund (profits to be distributed) was fixed as one-half the total profits after

[2] Manufacturers of electrical equipment, located at Philadelphia, Pa. Number employed at present is about 600.

[3] Makers of jewelry boxes, tags, and paper specialties, located at Framingham, Mass. Number employed at present is about 4000.

setting aside enough to pay the 8 per cent dividend on our preferred stock and 6 per cent on the common stock. The remaining profits went to the common stock. Three years ago the group to which this bonus fund was paid was considerably enlarged, and this year we have further enlarged it by taking in a large part of the sales force instead of paying them a bonus on the volume of sales, so that now about 68 individuals out of a total of 425 employees participate in the profit-sharing. We do not have any form of profit-sharing for other employees.

"The members of the group themselves take the initiative in making recommendations in regard to new people to be brought into it and can also discuss whether people who are in it should not be there. They understand that the total bonus fund will not be increased because there are more people in it. In order that those who are already in the group may not have their bonus decreased it is essential that new people who are brought into it will so improve their work as to increase the fund by at least the amount of the bonus which they will receive. It is from this standpoint that candidates for the bonus group are considered. The final decision as to who shall be in the bonus group is made by the management, but the recommendations of the group have much influence on the management's decision.

"The bonuses are proportioned to salaries, but are not uniformly proportioned. The higher executives receive a larger percentage of their salaries in bonuses than do the lower ones, so there are various sub-groups in the bonus group. The factor by which the salaries of those in the upper group is multiplied to determine the bonus is four [4] times as large as that used for the lower group.

[4] This has since been changed to twelve.

"The bonuses are paid only at the end of the year, but in order that everyone may know what progress is being made the profits are figured each month, and every member of the bonus group is given a blue print with a graph from which he can determine what his bonus will be at the end of the year if profits continue at the same rate as they have up to that time. Of course, they are informed and are fully aware that this sort of reckoning is highly uncertain at the beginning of the year and becomes more and more dependable as the year progresses."[5]

This plan has the following characteristics which attract attention: first, the subdivision of the participants into subgroups (of which there are six) on the recommendation of the profit-sharers themselves with the approval of the Executive Committee; and second, the payment to high executives of bonuses that are relatively large, in respect to salary, as compared with those received by minor executives.

The reason for paying relatively larger bonuses to major executives, and the basis of distribution now used, have been explained as follows:

"No objection was taken then at the inception of the plan, nor has there been since, to the general principle that major as compared with minor executives make a decidedly larger contribution to profits than would be indicated by their salary ratio, and so deserve a larger share of the bonus.

"A gradual application of this principle has resulted in dividing the bonus group into six subgroups. The number of groups and their relative participation is subject to yearly review. At the present time the share of participation in the

[5] James, Dennison, Gay, Kendall, and Burritt: "Profit Sharing and Stock Ownership for Employees" (1925), pages 257 to 259.

lowest group is proportioned to one-half salary, and in the highest group, to six times salary. For example, a man in the lowest group getting a salary of $2000 would have a share proportioned to $1000, and a man in the upper group getting a salary of $10,000 would have a share proportioned to $60,000. The range of the factors that proportion bonuses to salaries is 1 to 12, and in this hypothetical case the range in amount of bonus is 1 to 60. In our actual experience bonuses have ranged from 15 per cent of the salaries of those in the lowest group to two or three times the salaries of the higher executives, and have had a range in amount somewhat greater than 1 to 60."[6]

In the same article Mr. Leeds has presented the philosophy behind this bonus arrangement:

"I do not look upon the bonus plan merely as a means of getting the best effort from executives at the minimum cost to the enterprise. . . . The bonus should certainly be an incentive to call forth maximum endeavor, but I think it should be more than that and it can be made so if approached from a different angle.

"I look on the 500 or 600 individuals in the Leeds & Northrup Company as a group who have come together by mutual consent to carry on a useful and, if possible, profitable enterprise. Our bonus plan is part of an arrangement by which we endeavor to make a fair distribution of the fruits of our efforts. We seek to pay the great majority who contribute labor and skill, under the guidance of others, wages and salaries that shall be a proper reward for their effort. Those who rise above that

[6] M. E. Leeds: "Incentives for Executives," Annual Convention, Series No. 68 of American Management Association, page 4.

> rank and contribute more than directed labor and skill are entitled to larger compensation, which can be partly taken care of by salaries, but on account of the contingent and uncertain nature of the result cannot thus be fully met. Therefore, if the enterprise is successful, they are entitled to a further share in that success—a share which for each one is proportioned to his contribution."

Were this unique profit-sharing plan, for the executives and factory management and part of the sales force, expected to function by itself, its success might be doubted. It is important, therefore, to investigate the other elements which give it life and make it effective. Among these, the most important factors are that the concern is a prosperous, well-run enterprise in the rapidly growing electrical industry; that the making and selling of precision instruments needs unusually close coordination of research, manufacturing, and selling; and that the entire ownership of common stock is vested in the active management. There is a systematic watch over promotion which insures that each worker's rate is considered four times a year, and a Cooperative Association, which represents workers on matters of mutual concern to them and to the management. Joint arrangements are in force to provide insurance for sickness, disability, and death, and annuities after retirement. In addition the company has set up a trust fund to be devoted to the compensation of its employees in case of lay-off. The following description, which is part of an article written by Mr. Leeds, shows the place of these devices in the program of coordinated industrial relations.

> "In order to conserve the hard-won experience of the past and on that firm foundation build a structure for the future even more socially useful,

the executives must not only be competent but must also have a social sense of responsibility for the welfare of all those engaged in the enterprise as well as for that of the public. In the belief that there is no other single factor that will contribute so much to this viewpoint, we make it obligatory that the controlling power shall be vested only in those actively engaged in the business and that the executives shall be the real owners of the voting stock, and not responsible to absentee capitalists.

"The plan provides that only those who are holders of a form of employees' shares shall have voting rights. These employees' shares may be sold only to such employees as have been with the company for at least five years and who receive a salary of at least $1500 per year, but they are not sold by a set plan to anything like all of these. At any time that there is to be a new issue, the trustees, who are the qualified representatives of the holders of employees' shares, decide to what individuals new stock may be issued and how much shall be issued to each, it being the intention that this most qualified group shall select those who are most likely to contribute to the future welfare of the undertaking. When a holder of employees' shares goes out of the business for any cause, his holding is automatically converted into a form of investment shares which draw a fixed and preferred dividend, but do not have a vote except in the contingency of the dividend not being earned. *The employees' shares are sold, not given, to those to whom they are assigned.* Their value is ascertained by a fixed method, depending on the earnings of the business for a number of years preceding the time of sale. It will be noted that this arrangement makes it possible to allow any employee of experience to become a holder of the con-

trolling stock, and, further, that it intends to place the major holdings of this stock in the hands of those who are most competent to exercise control wisely.

"Naturally, the group of actual and potential executives is a minor fraction of the employees, and no scheme of organization could reasonably call itself democratic that did not take into account a very much larger group. To meet this situation the Cooperative Association was organized a few years ago and includes in its membership all of the employees of the company from the latest comer to the President. The association belongs, perhaps, in the general family of shop committees, but differs from most of such committees in its all-inclusive membership.

* * * * * * * *

"The name 'cooperative' is properly descriptive of the activities of the association in two ways. The first purpose of the association is cooperation among the employees in a wide variety of activities in which they can be mutually helpful. Among these may be mentioned athletics, entertainments, such as dances, dramatic clubs, etc., lecture courses, accident and sick relief associations, cooperative store, oversight of dispensary and lunch room, and the publication of a paper. The second manner in which the work is cooperative is in relation to the problems that have to do more directly with the business and in which the employees have a vital interest. Among these are the good order of all parts of the building and grounds, convenience and comfort of work places, locker rooms, washrooms, etc., plans for the most rapid possible assimilation of newcomers, hours of work, overtime pay, lateness and absence arrangements, holidays,

procedure in safeguarding employees in case of discharge, and wages.

"The Association has active committees on all of these subjects. Those which have to do purely with the activities of the employees as a group of people mutually associated, such as athletics and entertainments, function without any contact with the management of the business. Those which have to do with the second group of subjects, such as wages, work in cooperation with committees on the same subject appointed by the management. In other words, these committees are joint committees. Most of them are standing committees. Through the agency of these committees a large range of subjects of the class mentioned has had very frank and thoroughgoing discussion, and many of them are still under discussion."[7]

Dennison Manufacturing Company

No study of Managerial Profit-Sharing would be complete without some mention of the Dennison Plan, because for years the arrangements of this company have been recognized as outstanding. As in the Leeds & Northrup Company, the entire common stock is owned by active managers of the concern. Likewise, profit-sharing for the managerial group is but one stone in the entire structure of industrial relations. Unlike the Leeds & Northrup Company, which has no profit-sharing for those below the rank of foreman, the Dennison Company has two schemes, one for management and one for the rank and file. These two parts of the Industrial Partnership Plan are termed the Managerial Industrial Partnership and the Employee Industrial Partnership. Of these we are interested primarily in

[7] M. E. Leeds: "Democratic Organization in the Leeds & Northrup Company, Inc.," in The Annals of the American Academy of Political and Social Science, 3622 Locust Street, Phila., Volume 15, July, 1920, page 13.

the Managerial Industrial Partnership Plan which is called for short "M.I.P." and which is described in "Dennison Institutions" as follows:

> "The ultimate control of the policies of the company is in the hands of all managerial employees, while an important share of the internal management of the company is in the hands of the employees who are not doing work of a managerial nature. Investors in the company do not share in the management, and are given a fixed dividend in place of a fluctuating share in the profits. Two-thirds of the profits remaining after the payment of fixed dividends are distributed, in proportion to their salaries, among the managerial employees, because they are the most influential in the creation of profits; and the other third is distributed, in proportion to length of service, among those of the remaining employees who have been long enough with the company to become thoroughly a part of it. A Dennison employee is thus a true partner in the business, sharing in the ownership of its capital and with a share in its profits and in its management proportionate to the influence which his position gives him on the earning of profits and the experience which his job gives him in solving the problems of management."

Managerial Industrial Partnership Plan

"M.I.P. Stock gives to its owners an annual cash dividend and the responsibility of selecting the directors of the company. It is not transferable; and when a Managerial Industrial Partner ceases to be employed by the company or loses his M.I.P. rank, his Partnership Stock is exchanged for 7 per

cent second preferred stock of equal par value. Each year M.I.P. Stock is distributed to the Managerial Partners in proportion to their salaries. Managerial Partners, broadly defined, are sales managers, senior salesmen, department heads, principal foremen, chief clerks, and others whose work requires similar managing ability or a high degree of imagination or business judgment. Five years of service with the company is a prerequisite for Managerial Partnership.

"The directors of the company, who are all Dennison men, each with a definite, full-time managerial responsibility, determine the selection of Managerial Industrial Partners—subject, of course, to the restrictions of definition and to the challenge of publicity. Also each year the directors decide, on the basis of earnings, the exact amount of both stock distribution and cash dividend.

"By this change the investors who were not actively engaged in the business received a fixed dividend and had no power to vote. Remaining profits and the control of the company were given to those who could most influence profits and who held positions in the concern which enabled them to understand the broader company problems.

"Two restrictions were placed upon the otherwise complete authority of the Managerial Partners:

"1. If the Partners fail in their responsibility to produce preferred dividends to the full amount, control reverts to the First Preferred stockholders.

"2. Any Managerial Partner who does not consistently maintain managerial grade as determined by a yearly check-up of himself and his job, through job study and analyses, may be dropped from the Mangerial group."

The financial structure which results from the Industrial Partnership plan is portrayed in the following table:

TABLE VII *

Class of Stockholders	Nature of Group	Powers and Rights
First Preferred.	Investors only (former owners or their successors).	Non-voting; stock transferable; 8 per cent dividend.
Second Preferred.	Investors only (former partners or their successors).	Non-voting; stock transferable; 7 per cent dividend.
Managerial Industrial Partners.	Employees of five years' service or over, whose work is of a managerial nature.	Possess sole voting power; stock non-transferable with varying rate.
Employee Industrial Partners.	Employees of five years' service or over, not in managerial group.†	Non-voting; stock non-transferable with varying rate.

* "Dennison Institutions," Dennison Mfg. Co., Framingham, Mass., page 13.
† Formerly two years instead of five.

One feature of this interesting financial set-up is that a "melon" is cut each year and served to the Dennison organization; that is, the surplus is distributed annually in stock. It is important to note that the company has had a continuous and steady expansion which has required capital. The fact that the company has held to a uniform expansion rate in boom and depression is an indication of the calibre of its management. The amount of the stock distribution from 1913 to 1928 is shown by Table VIII, page 68.

The well-rounded program of personnel relations and the low labor turnover (which since 1921 has been less than 28 per cent) reveals something of the skill with which this company handles its industrial relations. Among these activities are the Employee's Cooperative Plan, which is

TABLE VIII

STOCK DISTRIBUTION OF THE DENNISON MANUFACTURING COMPANY

M. I. P. (*Managerial Industrial Partnership*)

Year (March)	Shares Distributed (Par, $10)	Number of Managerial Partners
1913	15,122	167
1914	18,604	211
1915	12,779	218
1916	12,884	228
1917	43,752	260
1918	19,015	288
1919	30,740	320
1920	57,363	364
1921	72,479	377
1922	22,838	374
1923	40,672	389
1924	50,908	393
1925	13,850	412
1926	34,510	394
1927	37,900	413
1928	22,978	393

E. I. P. (*Employee Industrial Partnership*)

Year (March)	Shares Distributed (Par, $10)	Number of Employee Partners
1921	36,266	1418
1922	10,201	1439
1923	19,711	1661
1924	24,295	1836
1925	5,901	2093
1926	16,606	2318
1927	17,635	2407
1928	9,675	2345

a works committee; the Unemployment Fund; the Men's and Women's Mutual Relief Associations; the Savings Bank Insurance; the Dennison Savings Fund; the Credit Union; the Clinic; the Suggestion System; the two social clubs; the lunch room; the library; and the *Round Robin*, which is the Dennison magazine. Outstanding among these activities are the Unemployment Fund and the systematic arrangements to provide educational opportunities and contacts for both manual workers and managers.

CHAPTER IV

DISCUSSION OF IMPROVEMENTS IN TECHNIQUE

UNFORTUNATELY, executive compensation cannot be viewed in the light of dependable statistical data. In our search for improvements in technique, which is our chief objective, we face the difficulty of having no figures with which to judge the value of an experiment. Consequently, we must check our tentative conclusions against the considered opinions of the executives concerned.

General rules of guidance must be few, indeed, because of the number of variables and the fact that in this case the essence of success is adaptability. The design of a profit-sharing device for executives may be likened to the problem of a tailor. The latter is helped but little by the general rule that a suit consists of a coat, vest, and trousers, each of which has certain pockets and buttons. Closeness of fit, not the presence of trousers, is the real criterion by which the suit will be judged. Likewise, if guide posts in our field are to be useful, they must be related to individual concerns.

With this precaution in mind, we may proceed to examine some debated questions. Certain problems arise and are settled at the initiation of a plan; others, which have to do with its operation, are recurring. Questions of the former type will be discussed first.

What Deductions Should be Made from Net Profits Prior to Management's Participation?

The answer to this question is greatly influenced by the financial structure of the company. If bonds are outstanding, interest must be paid. If preferred stock has been issued, dividends must be cared for. If these fixed charges

(economic sense) exist, it is almost universal practice to deduct them before a percentage is taken for management. It is also usual to deduct reserves. The Walworth Company not only deducts a variety of reserves, but uses them as a lever to equalize the profit-sharing chances in the various manufacturing plants. The smallest amounts are deducted in those plants with the least advantageous locations. Also, all taxes are usually deducted along with other fixed charges. It has been permitted in some cases, however, to base the Federal tax on the net profits remaining after bonuses are paid.

Types of Deductions

The principal difference of opinion in regard to prior deductions is in the treatment of stockholders. At least four methods are in use: to base their "wage" on "invested capital"; to base it on the par value of the common stock; to base it on the present value of the common; and to set up an absolute minimum (like $1,000,000) or a fixed percentage of net profits. It is a very common practice to subtract a fixed percentage on the capital invested in the business. No earnings are shared with management until this minimum is met. The stockholder's percentage is usually about 6, but obviously it should vary with the risk of the industry. Among the companies that follow this practice are E. I. Du Pont de Nemours and Company, General Motors Corporation, and the Morris Plan Corporation of America. The basic idea behind this treatment of invested capital is that capital can be either accumulated or bought like materials, and that the money now in use is entitled to a fair, but stable, "wage" corresponding to the fixed salary of an executive. The care which should be taken at the initiation of a plan to define net profits and the deductions which are to be made is well illustrated by the following method which is in use in one branch of a corporation that has several manufacturing units.

Method of Determining Net Profits

"The net profits of the Halifax [1] unit, upon which the profit-sharing fund is to be based, shall be determined as follows:

1. The loss or gain on Halifax unit operations for the calendar year, as shown on the thirteen periodic statements, will first be determined.

2. To this sum will be added, or from it will be subtracted, any adjustments (as for inventories or bad debts) which were necessary at the end of the year, or during the year, which were not included in the periodic figures.

3. If any goods except for Mill X are bought from our own mills, or elsewhere, on any basis other than market price, an adjustment of these purchases to a market-price basis will be made as heretofore.

4. Federal income taxes at the current rate prevailing at the time will be computed on net operating profits as determined under the provisions of the foregoing three sections, and will be deducted from net profits.

5. Interest at 6 per cent will then be computed on the following Halifax unit items, using the average of each for the year:

(*a*) Plant, at depreciated replacement value.
(*b*) Inventories.
(*c*) Accounts receivable.

6. The sum remaining will be the amount upon which the profit-sharing distribution for the year will be based."

The application of the above principles results in the following formula for determining the amount of the profit-sharing fund.

[1] "Halifax" is substituted for the real name of this plant.

TABLE IX

FORMULA FOR DETERMINING AMOUNT OF PROFIT-SHARING FUND

(1) Halifax operating profits for the year, as shown by periodic statements	$	
(2) *Add:* Credits to Surplus, or to Loss and Gain of previous periods, resulting from current operations, but not shown on periodic statements	$	
	$	
(3) *Subtract:* Charges of above classes	$	
	$	
(4) *Add* or *Subtract:* Adjustments of cloth purchases to market basis	$	
	$	
(5) *Subtract:* Federal income taxes	$	
	$	
(6) *Subtract:* Interest on investment at 6 per cent	$	
(7) Profit for year	$	
(8) Profit-Sharing Fund percentage of above	$	

The evolution of this plan points to the convenience of a deduction based on invested capital for any concern that has branches. This company had an arrangement which operated successfully for three years, in which the bank interest and preferred dividends of the branch were deducted from the branch's profits before management participated. Changes in the financial structure, incident to incorporation, have forced changes in the accounting procedure, because the financing is now done by the parent company. The deductions in the profit-sharing scheme have been changed so that now a percentage on the "investment in plants, inventories, and accounts receivable, is deducted from gross operating profits."

Another situation is presented by those concerns which have issued no securities other than common stock. If the

latter has a par value, many of these companies deduct a fixed dividend on the common, and management does not share until this minimum is earned. Mr. C. D. Garretson[2] believes that management hires capital and that the money put into the business should receive a "wage" adjusted to the hazards of the industry. In his plan, the deduction is 10 per cent of the outstanding capital stock, which represents the money put into the business. Surplus (reinvested earnings) is not included in the deduction and can be distributed to stockholders without affecting the profit-sharing arrangements.

Another viewpoint is that the deduction for the common stock should be a fixed percentage, but on the present value of the shares rather than par value. If the stock is on the open market, the price at which the public values it is known. But the present value depends so greatly on the expectation of future dividends that it is difficult to measure it if the stock is not on the market. From the variety of influences that affect a stock's value, such as future earnings as judged from present earnings and book value, it is difficult to set up a reliable method of measurement. Although it would be theoretically possible to have an annual appraisal based on earning power made by outsiders, the cost would be prohibitive for our purposes. Since this problem is faced in all companies with closely held stock, one device which is in use will be presented.

The Leeds & Northrup Company, Inc., uses a weighted five years' moving average of value, based on earnings, as a formula to determine the current value of each share. As pointed out in Chapter III, all the common stock is held by those active in the concern, and the Board of Directors is chosen from among their number. After the dividends are paid on the preferred stock, it becomes necessary to discover an equitable split of the remaining profits between ownership, *per se*, and management, *per se*. A clearly understood method of appraising the common stock is

[2] President, Electric Hose and Rubber Company, Wilmington, Delaware.

needed, so that a man leaving the concern may be compensated for his share in its growth.

In order to determine the present value of a share of common stock, the following formula is used.

TABLE X

1. The new profit, after deducting preferred dividends, and Federal Income Tax, divided by the outstanding employee shares = factor (F).
2. (F)×10 equals the "formula figure" to introduce into the formula below to represent the current year.
3. The formula to determine the current price per share is a moving average (weighted) of the "formula figures" for the last five years. (See 2, above.)

Formula:	*Column Y*
A, "Formula figure" of current year (see 2, above) ×3	= .....
B, "Formula figure" of last year ×3	= .....
C, "Formula figure" of 2 years ago ×3	= .....
D, "Formula figure" of 3 years ago ×2	= .....
E, "Formula figure" of 4 years ago ×1	= .....

4. Total of Column *Y* divided by 12 equals the current price per share of the common stock.

When Should Management Share in the Profits of the Entire Company, and When in Profits of the "Unit"?

The proper decision of this question turns on two points: the independence of the plant, branch, or department in respect to physical location and work; and the extent to which a powerful individual incentive for a small group is desired above team play with the entire company.

"Unit" profit-sharing is undoubtedly the answer for department stores, and selling organizations with branch houses. The stimulus would be almost *nil* if an executive in one of the sixty-five distributing houses of the Graybar Electric Company were to share in the general profits of the

whole company, because he has so little influence on the total. Yet his work has a tremendous bearing on the profit figures of his own "house," and a chance to share in its extra profits is a direct incentive to work hard himself and to cooperate with his three co-executives.

But if the strong spur provided by confining the participation to the profits of a particular branch causes a part of the business to be pushed to the detriment of the company as a whole, then the "unit" basis may need to be modified. This was the experience of the Walworth Company, which now bases one-half of the fund for its branch houses on the showing of that branch, and one-half on the earnings of the company as a whole. Also, a modification of the pure "unit" basis may be necessary to equalize the chances of branches or plants in different competitive situations. To illustrate the point, the managers of Childs' restaurants were paid a given percentage of their savings in operating costs. The variation in the conditions caused unfairness which led to the abandonment of the plan.[3]

This lack of uniformity in the jobs is especially apparent in chain stores. Although the Woolworth Company uses the "unit" as the basis for its district bonus, there is a wide difference of opinion as to whether profit-sharing is adapted to the payment of managers of individual stores in a chain. The chief stumbling blocks are the differences in opportunity to make money and the need of placing the best managers in the most competitive locations.

"Unit" profit-sharing is the obvious basis where parts of a concern are geographically isolated. It may also be employed to obtain quick results if one department is believed to be the key to a bad situation. However, if the cooperative effort of the entire managerial group is the chief aim, and if the various departments are closely interrelated, the managerial group should participate in the net operating income of the entire enterprise.

[3] James *et al.*: "Profit Sharing and Stock Ownership for Employees," 1926, page 126.

The Percentage Placed in Management's Fund

Of all the phases of our subject, generalizations on the proper size of the fund are the most dangerous. Approached from the standpoint of equity, the question verges on ethical grounds; and viewed from that of maximum incentive value, it involves explorations in psychology. Either of these ventures is likely to lead to heated debate rather than to enlightening data. Perhaps our safest course is to present the bases upon which the management's percentage may be allotted.

To seek an equitable division between owners and management is intriguing. Legal rights are not an issue, but the concept of a business as essentially a partnership (even though it wear the clothes of a corporation) has tremendous potential power in relation to our problems of "human engineering." If a business is treated as a partnership, obviously each one shares according to his contribution. Some managers may also be owners, but they would share as managers or as owners according to the value of their contribution in each role.

Where the partnership philosophy is adopted and practiced, there is still an important "missing link." In a given year, how much does ownership contribute to profits in comparison to active management? We cannot hope for anything better than an empirical answer, like 50–50 or 30–70, based on the judgment of the proprietor. A matter of this kind cannot be settled by rule or formula, but only by the *individual conscience*. The famous "Maison Leclaire" (Laurent-Fournier et Cie, Paris), a house-painting and decorating concern with about 1140 employees, pays 15 per cent of the extra profits (after 5 per cent on investment) to the managing partners, and 85 per cent either directly or indirectly to the staff workers. The Leeds & Northrup Company has used a 50–50 division between owners and mangement. However, no general rule could be formulated that would apply to all companies, or even to the same company in different years.

But if it is desired to make the management's fund just large enough so that the individual shares will provide the greatest spur for their recipients, the difficult question is raised as to how much financial incentive gives the maximum return. For the average man, is it 15 per cent or 30 per cent of his base or stated salary? Mr. Frederick W. Taylor believed that for manual workers the following percentages of the base rate were needed to provide the best incentive.

1. For ordinary shop work	30
2. For work involving bodily fatigue but no skill	50–60
3. For work involving skill or mental application	70–80
4. For work involving skill, mental application, strength and fatigue	80–100*

* F. W. Taylor: "Shop Management," Harper & Bros. (1911), page 26.

If the bonus is too small, it will seem petty. If too large a bonus is given a young man, he may be spoiled. But the optimum or most desirable size for a bonus differs with the individual. How people of differing temperament, age, ability, and family need will respond to money incentives involves all the variables that comprise the "total situation" of any executive. Perhaps behavioristic psychology, used in those branches of business where jobs are somewhat comparable, such as banking, insurance, and railroading, offers the greatest promise of a solution.

In the meantime, companies that desire to find the greatest incentive value will have to gauge roughly, for an average year, the size of bonus which they think will have most effect. They must consider whether their executives like safety or adventure, whether they are old or young, whether their base salaries are large or small. Obviously, the $200 bonus which might make a foreman happy might seem so petty to the sales manager as to do harm. In its announcement to its executives, a well-managed textile concern has thus described the problem.

> "There is no mathematical formula which can be applied to the development of any profit-sharing

plan, or to the determination of the correct amount to be divided. The working out of such a plan is, rather, a matter of judgment, equity, analysis of past results, and forecasting of the future.

"Any such plan should result in a fund which will make possible, in good years, a payment large enough to be really worth while, but not so great as to be out of proportion to the possible contribution of the individual to the profit result.

"This amount should vary in a definite way with the variations in the outcome of the business, and should be computed on an understandable and predetermined basis, not subject to arbitrary or capricious change."

Should the Profit-Sharing Scheme Be an Individual or Group Arrangement?

The well-known tonnage basis which has been used in the steel industry for thirty years is often a part of an executive's individual contract. There are a great number of plans in which arrangements are made with sales managers, district sales managers, salesmen, and plant managers whereby they share independently in the net earnings. As pointed out by Mr. Dennison, such a contract provides a powerful spur to action, but sets up in the organization selfish rivalries that may be destructive.[4] Where the single effort of an individual has a large influence on the balance sheet, and where quick results are needed, these contracts are effective. Where the participants share as part of a group, the direct spur is weaker, but the "reverberative" influence of the others of equal rank who are affected is an ever-present driving force. A man may become too satisfied with his present performance and earnings if he is working for himself alone, but where a group of his fellows suffer

[4] H. S. Dennison: "Incentives for Executives," Annual Convention Series No. 71, American Management Association, New York, 1928.

from his mistakes or laziness he cannot shirk if he wishes to keep in good standing. Mr. Dennison feels that the good opinion of a manager's fellow-executives is the most powerful single influence of the Dennison plan.

Perhaps the chief reason for participation in a group is that this method provides a direct reward for team play. The increasing need for coordination, forced on us by the multiplication of staff and functional departments, has placed a premium on cooperativeness.

If Profits Are Shared, What Relation Should Salaries Bear to the "Market"?

The base salary may be treated in three ways. Mr. Charles Schwab favors a low base of about the same size for all executives, so that the emphasis is placed on the earnings contingent upon performance. This is a feature of the arrangements of the National City Company, of which Mr. Charles E. Mitchell is President. The president of a rubber company favors the same method because he wants his executives to share losses, and a prominent paper concern pays to its profit-sharing executives only nominal salaries. Mr. J. P. Jordan has suggested a base salary just high enough to cover the necessary expenses of supporting the family and educating the children.[5] An executive could exist on this base, but could not "make money" unless he earned a bonus. The third and most common viewpoint is that the stated salary should represent the market rate for the job.

The last policy has been adopted by such companies as the Graybar Electric Co., Walworth Co., the Lewis Manufacturing Co., the American Rolling Mill Co., and many others. The American Rolling Mill makes a specific statement of it in the description of its Special Compensation Plan: "Salaries are regulated after giving due consideration to the character and responsibility of positions held, effi-

[5] J. P. Jordan: Series No. 73, American Management Association, 1928.

ciency, general ability shown in discharge of duties assigned, loyalty to company interests, term of service, and as far as possible to salaries paid to persons holding comparable positions in competing companies. These factors are considered independently of any plan for Special Compensation."

The Lewis Manufacturing Company has stated its policy as follows:

> "It has been and is the policy of the company to pay to the holder of each position a salary which represents adequate compensation for the responsibility assumed, the quality of work performed, and the results secured, in as full a measure as it is possible to appraise these factors under conditions which do not lend themselves to mathematical determination.
>
> "These salaries are a fixed and definite charge against expense, which must be met whether or not there are any net profits."

For the rank and file, bonuses (as distinguished from piece work) should be an addition to regular wages because they are an "extra reward for extra effort," but this is not so important in the compensation of management. Also, it is probably less essential to pay "going" salaries in the case of participation under an individual contract than in profit-sharing with a group, for the former is usually used when the factors affecting profits are largely under individual control. In any case, profit-sharing will excite exceptional interest and initiative only to the extent that it provides pay over and above what an executive knows he can earn elsewhere.

The discussion of this point is dangerously academic, for the great majority of executive positions, especially those of higher rank, have no market rate. What a sales manager can earn is influenced by the type of product, the company's need of volume, and the manager's ability to sell his services to advantage. Even though the company

wishes to pay salaries up to the market, the policy is difficult to follow. If the possibility of sharing in profits is mentioned before hiring, it enters into the applicant's evaluation of the job. Likewise, the profit-sharing arrangement is a factor in the decision of old employees as to whether they should accept or refuse offers to go elsewhere.

Unless an owner wants a strong stimulus for quick results, or wants executives who crave adventure, the safest policy is to consider profit-sharing as an addition to, and not a substitute for, a "going" salary. Low base salaries enforce loss-sharing on the key men, yet only the biggest executives are fitted financially and temperamentally to stand losses that reduce their fixed salaries. Although the failure to pay a bonus in a bad year serves as a useful reminder that profits are in a measure dependent on effort, the employee will worry about family expenses if his base salary does not cover the necessities, or if bonuses have been paid with such regularity that he has raised his scale of living to absorb them all. In order that the bonuses may not be considered as part of salary, the profit-sharing arrangement should not provide bonuses of uniform size each year. Moreover, the recipients should learn from contact with the top executives that these bonuses are not to be counted on as part of income.

Should the Payments Be in Cash or Stock, Deferred or Not Deferred?

Although two-thirds of the plans found provide for annual payments in cash, it is by no means certain whether cash or common stock is the better. Mr. Dennison champions the use of non-transferable common stock wherever possible, because it is a positive means of insuring the use of bonuses to acquire ownership. The Bank of Italy (its plan covers all its employees) and the General Motors Corporation are other examples of those who pay in stock.

Some companies pay in cash because they do not wish

to attach "strings" to the payment. This is the feeling of Mr. C. D. Garretson, President of the Electric Hose and Rubber Co., and many others.

Another group of companies reserves the right to pay either in cash or stock, or both, at the convenience of the company. This is the provision in the plans of C. G. Conn, Ltd., Elkhart, Indiana; of the Leeds & Northrup Co., Inc., Philadelphia; and of the Dennison Manufacturing Co. The reasoning behind this provision is that a company can pay out to its profit-sharers only what it happens to have available. If it needs working capital to expand its facilities, certainly it will want to pay in stock in order to make use of the cash. Or if it happens to be so fortunate that its profits outgrow the need for improvements and plant extensions, a company will want to distribute cash instead. This is exactly what happens in a partnership: the partners take what the business has to give.

Putting aside the question of company convenience, what are the relative merits of the two forms? For maximum incentive results over a short period, cash in the hand seems more effective than stock in the vault. Young men, especially, prefer cash to stock. Mr. Dennison has noticed that in his company the stock payments have had relatively little effect for the first two or three years, but that as the certificates accumulate and the annual cash dividend grows larger, the incentive operates continuously and with increasing strength. He believes that cash is more easily forgotten in the interim between payments.

Whether a concern feels that cash or stock is preferable for its particular group of managers, it is a wise precaution to provide in the plan for payment in either form. In this way, the company need not be financially embarrassed by having to pay cash to executives when the money is badly needed by the enterprise itself.

The deferred feature, which is used by the General Motors Corporation as an aid in preventing turnover, is felt by that company to be an important element in the success

of its arrangements. The executive receives his payments over a four-year period, just as insurance salesmen receive commissions which are deferred over a long period. The same idea is introduced by companies whose accounting procedure forces them to postpone payment until March 1 or April 1, in order to permit the books to be closed for the previous calendar year. For example, the Graybar Electric Company pays its bonuses on April 1 to those who are still on the payroll. Exceptions to the rule may be made at the company's discretion.

It is believed that payments should not be deferred beyond the period needed to close the books. Turnover is the result of so many factors that it is doubtful whether good men will be permanently retained by merely deferring payments. Moreover, if men are kept against their will, low turnover has become a false god. Certainly a man who stays on merely to get his bonus, wishing all the while that he were with a competing company, is not an asset.

Methods of Selecting Participants

We now proceed with the questions that must be faced both at the inception of a plan and with each recurring year of its operation: "Who is to share?" and "How much?" At least four methods of selecting participants are in use.

1. Arbitrary inclusion of all above a certain salary minimum.
2. Selection by some high officer, such as chairman of board, or president, based on judgment, usually of subjective qualities.
3. Suggestion or nomination of additional sharers by those already participating.
4. A definite objective technique of job analysis, aided by a rating of performance and an analysis of salaries.

A salary minimum has been used by the General Motors Corporation and the Sonora Phonograph Company. Some

device of the kind is almost imperative to secure uniformity in an organization as large as General Motors. It has two vital weaknesses: the arbitrary location of this salary "gate" may leave out many who contribute appreciably to profits; and salary levels may suddenly rise and admit employees who are no more worthy to share than they were before. Since a few dollars' difference in salary may affect eligibility, suspicions of deliberate juggling may be aroused. The straight salary line of $1500 (or $1200 plus seven years' service), formerly used by the Dennison Company, caused trouble when salaries were suddenly advanced by the World War. It was found necessary to abandon the salary line for a selection based on an analysis of the individual jobs.

It is a very common practice for the owner, president, or chairman of the board to select the profit-sharers, aided in large companies by the department heads. This method is followed by the du Pont Company, the Lewis Manufacturing Company, and the Electric Hose and Rubber Company. It often proves satisfactory when used by an able administrator, provided he is close enough to the eligible employees to have sufficient knowledge upon which to judge. The weaknesses of the method are a lack of clear-cut, objective guides; a tendency to generalize about *part* of a job, not the whole; a tendency for selection to be affected by proximity to the chief; and the inevitable bias of personal opinion. The last-named factor may come to be considered so important by the managerial group that they "play up" to those responsible for selection. Although far from ideal, this method seems preferable to No. 1.

In the Leeds & Northrup Company, the fund is a fixed percentage of company earnings, and those who comprise the six participating groups may suggest names to be added if they feel the incentive to the newcomer would cause the fund to increase by more than the new man's bonus. These recommendations for addition to, or removal from, the group are subject to the veto of the Executive Committee. Nevertheless, the latter gains the benefit of the intimate knowledge

which executives have of the accomplishments and weaknesses of their co-workers. This device, which the writer has found in only two other plans, is probably not the final word in selection, but it offers a practical check for more objective methods of classification when they are perfected. This device is a simple method which can be used immediately. The key to its successful operation is to fix in advance the percentage which the fund bears to net earnings. Otherwise, those already in might be tempted to help their friends get in. If the fund is fixed relative to profits, however, then the net earnings of the company must grow after the enlargement of the group or individual bonuses will be smaller. It was the experience of the Leeds & Northrup Company that the expansion of the group from the five major executives to about sixty-eight participants was a benefit to those who shared originally.

What is needed for the proper selection of the bonus group is a perfected job-analysis technique for managerial work. The writer can offer no such technique, but can merely point out the steps by which the problem may be approached. He is indebted to the Dennison Manufacturing Company for the benefit of its experimental work over the last four years, which is the source of most of the ideas presented here. This analysis was begun by Mr. John S. Keir of the Dennison Company, who was aided during two summers by Dr. Alfred H. Williams of the Wharton School and Dr. Donald Paterson of the University of Minnesota. During one summer these investigators included L. B. Hopkins, formerly with the Scott Co., later in charge of personnel relations at Northwestern University, and now President of Wabash University. The work has been continued by J. S. Keir and E. P. Hayes. In a field as difficult as this one, progress is necessarily slow, and at this stage conclusions must be highly tentative. It is hoped that companies in a variety of industries will add, by their own experimentation, to our knowledge of methods of measuring managerial work.

The successful solution to an objective method of picking the bonus group appears to demand the following tools:

1. Job analysis to sort the jobs into those that should be included without question, those that should be positively excluded, and those that are doubtful. If there is a clear-cut determination of those that are "in" and "out" we can confine ourselves to the doubtful cases. Such an analysis involves the careful, precise study of each position to discover the upper and lower limits of the opportunity it offers to contribute to management. It indicates both the maximum possibilities inherent in the job, and the minimum of work required of its occupant.
2. A rating of men (as distinct from jobs) to decide whether holders of the doubtful jobs should be "in" or "out."

The "managerial content" varies from almost nothing in the job of a punch-press operator to nearly 100 per cent in the job of a chief executive.[6] But, since an exact definition of "managerial content" is impossible, our attempts to measure it must be indirect rather than direct. The devices with which the Dennison Company experimented have been summarized by Mr. Keir as follows:

> "1. A range of jobs was classified according to consensus of opinion: *A*, *B*, or *C*. Out of each group a number of jobs were selected for careful examination.
>
> "2. It was necessary to have a standard approach to each job, if we were to get a job-to-job comparison. Therefore a worksheet was drawn up by which every job was subjected to exactly the

[6] "Managerial Content" refers to the contribution to the management of the concern and includes such elements as supervision and direction of the work of others.

same analysis. Each analysis was checked by the individual and his superior. Every item on this worksheet has been defined with scrupulous care so that it will always mean the same thing no matter to what job it may be applied.

"3. It was apparent that in each job there is a maximum and a minimum potentiality. As a measure of this potentiality we thought in terms of the possibility of the job contributing to net profit over and above simply the profit requirement necessary to continue as a going concern. Each job was rated on each of the 22 items both in the minimum and maximum columns. This rating was done on the basis of 0–5 and no effort was made to weight the items, as we learned after a great deal of experimentation that weighting really showed up in the totals, and weighting items merely made for confusion.

"4. The ratings on each item of each job, both maximum and minimum, and the total of each were placed upon a master chart. Over 100 cases were taken and enough of each—of *A*, *B*, *C* jobs—were included so that we obtained a good cross-section of the whole organization. This chart is felt to be a pretty true picture of each job in the organization in reference to every other job. Furthermore, it does show some natural grouping of jobs at various points and affords a basis of distinguishing as among groups.

"5. The same rating sheet used to rate the job was used to rate the individual in the job, both on a minimum and maximum basis.

"6. Under each item a great deal of objectivity is given the technique in that reports and other objective data used in connection with the item are considered in rating. In rating individuals, salary and salary history and similar facts are use-

ful additions in finally determining a person's status.

"We have used this technique for a year and further use brings out some very interesting things:

"1. This technique rates *jobs* very accurately but leaves a great deal to be desired for rating individuals.

"2. A man-to-man scale or its equivalent is necessary in rating individuals. Furthermore, horizontal comparisons are useless. Foremen and salesmen for example, are not to be compared, but foremen with foremen and salesmen with salesmen."

Distribution of the Fund

Closely allied to the selection of profit-sharers is the problem of how the fund should be divided. The methods in use are as follows:

1. The judgment of some high official as to the relative merits of each manager's work. This method has already been analyzed in connection with selection, and since no technique is involved, it will not be discussed here.
2. Apportionment of the fund according to the percentage that the individual salary bears to the total of the group.
3. Division of the fund in proportion to the margin of each salary over a given minimum, such as $1500 or $2000.
4. Classification of managerial group into classes according to the appraisal of their several contributions. The fund is split into smaller funds for these classes according to the approximate value of their contribution.
5. In case classes are used, suggestions from participants as to promotions, subject to the veto of the presi-

dent, or other high official, utilize the intimate knowledge of the participants. This device is a useful check and may be employed here in the same manner as in the selection of participants.

6. A definite technique for rating the performance of each individual. Perhaps a "man-to-man" rating [7] of men performing similar functions is a partial answer. This is the point at which experimentation is most difficult and most needed.

Individual salaries present the most convenient basis for apportioning the fund, and they offer several advantages as a basis for distributing the shares:

1. The salary basis is simple and easily understood.
2. Chances of ill-will are eliminated by using one basis for both salaries and profit-sharing bonus.

In spite of their tempting advantages, the use of salaries alone is not a satisfactory answer if the profit-sharing group is not so homogeneous that the participants may be considered almost on a par as to rank. This condition would be found only if the profit-sharing were confined to major executives (i.e., the top three or four executives who are responsible for the major activities of the business). A case where the apportionment of the extra compensation according to salary has proven defective is C. G. Conn, Ltd., whose plan is being altered because of this defect. (See Chapter III.)

If the participating group includes executives who differ widely in rank and importance, salaries alone do not provide the best basis of allocating the shares. The reasons might be classified as follows:

1. For perfectly legitimate reasons, salary advances may not be proportionate to increases in the value of performance.

[7] Rating managers relative to each other.

2. The scarcity of certain types of skill may force a company to pay to certain specialists salaries which, relative to the value of the contribution, are higher than the average of the executive group.
3. In order to provide the maximum of interest and incentive for the recipient, the bonus must be proportionately larger for those with high salaries than for those with low.

That an executive's salary ever grows in exact proportion to his performance is unlikely. It is easy to recall examples of salaries which are too high because of nepotism or other forms of favoritism. The opposite situation may also be found where certain executives who hold the key to the top-control of the business contribute much more to the concern than it feels it can afford to pay them. The enterprise may recognize the vital influence of one individual and yet believe that it cannot afford to make his salary commensurate with the value of his services. The thought is often present that the unusual contribution may be temporary and fleeting, but that the salary, once raised, could not be reduced without embarrassment.

There are also certain more legitimate reasons which explain the divergence between advances in pay and performance. Many chief executives feel that a young man may be completely spoiled by being raised too rapidly. It is entirely possible that the young executive who has the ability to shoulder suddenly increased responsibilities in the business may not be strong enough to stand sudden prosperity. In order to avoid the trouble and loss that results from a case of "swelled head," some companies are careful to see that the younger members of the management group do not receive, in any year, increases of over 15 or 20 per cent, even though their work may have doubled in value.

Since the participating group contains men who handle different functions, such as marketing, production, finance, and research, it is unbelievable that the economic forces

behind the terms "supply" and "demand" should play upon them uniformly. Research men with the specialized knowledge of a new field may be extremely scarce, or salesmen may command higher salaries than production executives of equal ability. The marginal productivity of this research work to the company (as estimated by the top-management) will determine the upper limit that the company will pay for the specialist; but the lower limit may be dictated by scarcity, and may be much higher in proportion to productivity than the salaries of the general run of the executive group.

Careful attention to the basis of allocating the shares is essential if the plan is to build good-will and not ill-will, but it is equally important that it should act as a spur to greater effort, initiative, and interest. Although any general approach to the question of incentives is dangerous because those who receive them react according to their individual differences, there is one general proposition which should be examined. Should the bonus offered to a high-salaried executive be *proportionately* larger than that which would be offered to him if he received a low base salary? The author assumes that unless a bonus had some relation to a worker's need, as in the case of the "cost of living" bonuses of the World War, there would be general agreement on the proposition that the bonus for the high-salaried manager should be larger in *absolute* terms. The question that needs analysis, therefore, is whether the bonus should be larger both absolutely and relatively.

The answer involves both the psychological reactions of the individual under different environmental conditions and the tendency, which has already been mentioned, for a high executive's usefulness to outgrow his salary. Since it concerns his "total situation" it includes not only his own desires but the wants of his family as well. It is a question dealing with both personal attributes and family expenses. One hint as to the answer may be derived by asking: "What do executives generally do with salaries and bonuses which

they receive, and for what do they desire additional compensation?"

Most executives have family needs that must be met, irrespective of the size of their incomes. Food, housing, clothing, and a variety of necessary items that may be grouped under "miscellaneous" must be paid for if the family is to be held together, even at a low standard of living, such as the "decency" level. Assuming that the minimum needed to maintain a "health and decency" level for an office worker, his wife, and three children, in Brooklyn (New York), in 1926, was $2084, this sum would represent expenditures that were absolutely essential to *any* executive with a family of similar size if he lived in Brooklyn.[8] These expenses would have the first call on his income whether the latter were $3000 or $30,000. Since part of the total family income is spent for uncontrollable items a bonus or a raise in pay may be judged by its effect on the margin above them. The part of the salary that would represent real achievement to both the low and high salaried man would be the surplus above his family necessities. As John Wanamaker aptly put it: "The part of the blanket which keeps you warm is the part that hangs over."[9]

As a result of this reasoning we come to the conclusion that the salary margin over a fixed minimum, such as $2000, or $3000, or $5000, represents a workable method of distributing the fund. It is aided by using sub-groups of participants for the groups of higher executives need larger minimums. This device seems preferable to the use of salaries because it more closely reflects individual performance. If the bonuses of high executives are relatively larger than those of low executives, they not only have greater incentive power but are more equitable.

Another device which seems equally effective as an aid in making the bonuses correspond to performance is the use

[8] National Industrial Conference Board: "The Cost of Living in New York City, 1926," page 114.

[9] Whiting Williams: "Mainsprings of Men" (Charles Scribner's Sons), 1925, page 17.

of classes, or sub-groups, within the participating group. Whereas the "salary margin" method is based on salaries at the *end* of the profit-sharing period, the placing of men in the classes should be done at the *beginning*. The executive should know in advance to what class he belongs and what percentage he will receive of that class's fund. Then, if monthly information is furnished as to earnings, the executive is in a position to estimate, from the current showing of the company, how large his bonus is likely to be. Treacherous as analogies may be, the author cannot refrain from comparing incentives for executives with those for manual workers, of which our knowledge is so much more extensive. It is almost axiomatic that workers must know their rate before they begin to work, even though the absolute amount depends on their output. We do not start piece workers on a job without telling them the piece rate in advance. Neither do we attempt to use premiums or bonuses without first announcing how they will be computed. We know that the machine operator will not be spurred to greater output by an indefinite hope for pay to be figured he knows not how. It is argued that executives are "different," and that their faith in the fairness of the company makes them willing to work first and learn the amount and rate of their reward afterward. But are the motives that impel a manager so different from those of a machine operator that we can disregard the definiteness of rate? This reasoning leads to the conclusion that if sub-groups are used to help grade the executives, the latter should be classified at the beginning of the period on the basis of their work of the year just preceding.

The question then arises as to how many sub-groups there should be. Mr. Raskob feels that the managerial work of the General Motors Corporation may be divided into three classes: first, administrative positions largely concerned with formulation of policies; second, the positions charged with the responsibility of executing those policies with relatively broad powers over the methods used

to secure the results; third, directed jobs where the individual is doing work of a supervisory character, but where he himself is under immediate direction.[10]

Another corporation feels that it has three natural groups of employees, two of which would fall within our definition of "managerial." In the first group are the executives, including everyone from the president of a subsidiary company down to the first line of supervision. This group comprises everyone who has direct authority to manage and to coordinate the work of others. In the second group are the staff employees who aid the line executives, who help in the planning of the work and in solving problems that the line executives do not have the time to study. This group includes the engineers, statisticians, research men, and others of an advisory nature. The third group comprises the rank and file. As has already been mentioned in Chapter III, the Leeds & Northrup Company classifies its general and production executives into six groups. President S. O. Martin of the Sonora Phonograph Company, Inc., has suggested that all executive jobs can be divided into two groups which may be termed *A* and *B*. In Group *A* he would place those who originate and execute policies, and in Group *B* those who assist Group *A* in originating and executing policies. He suggests that in order to make the above classification effective Group *B* should include positions within the salary range of perhaps $2000 to $6499, and Group *A* those above $6500.

It is believed by the writer that in the medium-sized manufacturing business only one natural boundary, or difference in kind, can be detected within the managerial group. This division is between those executives, usually three to four in number, who head the major columns of responsibility, and all others of management rank. These top-executives, the general manager, general sales manager, general factory manager, and perhaps the comp-

[10] John J. Raskob: "Management: The Major Factor in All Industry," Industrial Management, September, 1927, pages 192–195.

troller (of the modern type) can usually be separated from the others without much question or jealousy. Although finance, sales, and production comprise the major functions of the ordinary manufacturing enterprise, there are concerns in which purchasing, engineering, research, or personnel may take major rank. However, where this is the case their importance is generally recognised and admitted. Below this natural division, clear differences in kind are impossible to detect. The proper number of sub-groups then becomes a question of choosing between the advantage of a gradual series of steps with small differences, that can be obtained with five or six classes, and the disadvantage of increasing the troublesome borderline cases by creating many boundaries. Perhaps it may be suggested that below the top-executives, the sales and production departments be classified separately, and that at least two sub-groups are needed in addition to the major executives. The minimum number of classes would, therefore, be three:

1. Major executives (or officers) who are under little or no supervision.
2. Principal assistants and department heads, who work under some supervision.
3. Minor executives who work under close direction, but who influence profits to an appreciable degree.

The most difficult question of all has not been answered. How can the executives be judged according to performance in order to place them in the proper class or to rate them fairly? Mr. Charles E. Mitchell, President of the National City Bank, says that in his judgment the bonus distribution is the critical point in executive profit-sharing. Consequently he obtains the opinions of each participant as to the proper apportionment before he, as President, makes the distribution. The Leeds & Northrup plan of having the members of each of the six classes suggest those who should be added from below is a practical expedient which has been described already. The final answer is probably to be found

in the perfection of a technique for rating executive performance objectively. The "man-to-man" rating which was mentioned in Mr. Keir's summary of the Dennison experiment is one approach, but not necessarily the only one.

It must not be forgotten that the problem of distributing bonuses is a dual one, for it involves both the measurement of results and the administrative use of those measurements. The latter must always belong to the art of managing a business, but the grading of executive accomplishment challenges us to seek a solution through continued experimentation. The difficulty of this puzzle is matched only by the possible rewards. An objective rating demands measuring sticks in the shape of definable, clear-cut tasks, which can later be compared with records of performance.

This method has proven its worth in the case of manual workers. But even a lathe hand's work is not completely measured by mere quantity of output, and the intangible elements are largely unrecognized in his piece-work rate. In executive positions these intangibles are predominant, and the cooperative effort which managerial profit-sharing is peculiarly fitted to stimulate is the joint result of many forces. Herein lies the difficulty of substituting measurement for rule-of-thumb methods, since tangible expressions, such as financial and operating ratios, sales quotas, production schedules, and budget estimates usually reflect a joint result without indicating the influence of individuals. Furthermore, a task set up from job analysis is affected by the influence that the job and its occupant have on each other.

Perhaps the solution to the measurement of management is first to study its tangible aspects, to express them in quantitative terms, and to set up the corresponding records; then to develop a supplementary rating that will check the intangible elements which abound in an industrial organization.

CHAPTER V

CONCLUSIONS

Where tried, managerial profit-sharing on a predetermined basis seems to have had exceptional success. The small number of reported failures and the testimony of owners and chief executives bear witness to its worth. Indeed, it seems strange that it has not been adopted more widely. The explanation lies undoubtedly in the newness of the field and in the secrecy which enshrouds it. Informal bonuses for executives are apparently numerous, though highly secret. Aside from the doubtful advantage of demanding no careful forethought, however, these bonuses seem inferior to predetermined profit-sharing.

It might seem at first glance that the sharing of profits with management would be effective only where the business is stable and where it is sufficiently prosperous to permit profits to be distributed with some regularity. Although formal plans have been worked out most often in fairly prosperous companies which have passed the experimental stage, there is no evidence to indicate that profit-sharing for executives would not be advisable in businesses with high risk and a widely fluctuating rate of profit. The arrangements would probably work less smoothly than in stable industries, yet with more effect than straight salaries.

The beneficial effect of this form of compensation on the quality of management results from three forces: the direct influence of the money reward, the "reverberative effect" of the criticism or approval of other profit-sharers, and the lubricating effect of the profit-sharing arrangement. Of these, the direct money incentive may act more powerfully

on high executives, whose bonuses are large and whose effort is more closely related to the earnings of the business, than on the less conspicuous employees who are on the fringe of so-called management. A foreman, since he controls but a small section of the whole enterprise, can see less direct connection between his effort and the earnings of the business than can the sales and production managers.

However, the desire for the money reward may prove less impelling as an incentive than the "reverberative effect" (as Mr. Dennison calls it), which the profit-sharers as a group have on the individual participant. The criticism of those men of similar rank whose pockets are touched by the mistakes or poor judgment of an individual is a powerful spur. The desire for the esteem of fellow-executives may exert as much, or more, pressure on a man than the hope for his own financial gain.

One of the most pleasing effects of the profit-sharing arrangement is the lubricating action which reduces friction in the organization and places the emphasis on cooperative effort rather than on the petty desires of individual self-interest. Not only does it aid in overcoming some of the natural inertia which opposes new steps or policies, but it awakens a unity of purpose that smooths the way for many decisions which otherwise would be difficult to put into effect. The business machine tends to run with less friction and more speed.

It is imperative that the plan adopted by an individual company should fit its peculiar needs and conditions, and that it should be altered as the needs change. A profit-sharing plan may be thought of as a suit of clothes which is satisfactory only if it is the right size, and if it is molded to fit the peculiarities of the figure of the wearer. A vest that is too tight for comfort can be no more objectionable to its unhappy owner than a profit-sharing plan that has been "lifted" from a magazine or from another concern without careful adaptation. However, the operation of a plan is more likely to be satisfactory if frequent changes can be

avoided by forethought when it is designed. Changes made each year in the essential features of the plan tend to cause unnecessary friction and to undermine confidence in it.

Design of the Plan

In the design of a plan, five vital questions must be answered.

1. Who will be eligible to share?
2. What part of net earnings will be allotted to management?
3. Will the participants share only in the profits of their own department, or in the operating profits of the entire company?
4. On what basis will management's fund be apportioned?
5. In what form will the payment be made?

The question as to who should share might be roughly answered for manufacturing concerns by including "those above the rank of assistant foreman," but no such rule-of-thumb measure is adequate. The test of eligibility turns on the opportunities which are afforded by the job to contribute to profits in an *appreciable* degree.

Such an evaluation of jobs can best be made by "job analysis," aided by a rating of actual performance. The analysis helps to determine the upper and lower limits between which the job allows its incumbent to contribute to management. Such an objective study will reveal that the requirements and opportunities of some positions are so great that their holders will share whenever profits are distributed. Another group of jobs, at the bottom of the list, will have such routine duties that the employees who hold them will be definitely barred from participating. Between these two groups will fall the difficult, or borderline, cases in which the final decision will depend on actual performance. In this third group, the limits imposed by the job permit a

man to make an appreciable contribution to profits only if he does his work with more than ordinary initiative. If he performs merely the routine duties necessary for the holding of the job he should not be eligible to share in the profits. Consequently, an appraisal, or rating, of the work of this third group of employees is necessary in order to decide whether or not they will be included in a given distribution.

Two useful checks for the proper selection of the eligible group are a payroll analysis and the suggestions made by those already in the group as to others who should be added. Such suggestions are valuable only if the percentage of "extra" profits which forms management's fund is fixed. The payroll analysis involves the making of a frequency chart for the purpose of observing the natural groups into which the salaries fall. Since borderline cases are the most troublesome and dangerous, both of these checks aid in their satisfactory disposal.

The answer to Question 2—"What part of profits will be shared?"—is a matter of financing and conscience. The deductions prior to participation by management must be decided by the form of the financial structure of the company. After prior charges are paid the percentage of the remaining net earnings which the owners allot to management will depend on the owner's conscience as to what is fair to both parties. No general rule can possibly be laid down as to what should be the final split between ownership, *per se*, and management, *per se*. Each individual company must seek its own empirical solution which will reflect the contributions of each, insofar as they can be fairly judged. But management's percentage should be announced at the beginning of the period.

A form of deduction often used is to subtract from gross operating income a fixed percentage of the invested capital before any share of profits is paid to management. Usually from 5 to 10 per cent of the capital employed in fixed assets, inventories, and accounts receivable is set aside. This is

equivalent to a deduction based on combined capital and surplus. It is advisable that the method of computing the deductions be definite and known in advance.

Another procedure is to deduct from gross operating income all fixed charges and dividends on preferred stock and to pay to management a percentage of the remainder. Sometimes a "fair wage" for the common stock of 6 or 7 per cent of par or market value is set aside before management participates. This should vary with the risk of the industry and the current interest rate of money. The fixed charges, referred to above, include interest on funded debt and other interest, depreciation and other reserves, and Federal taxes.

Question 3 might be stated as a choice between "unit" and general profit-sharing. The former is found in companies that permit the executive to participate only in the earnings of his own department, and the latter in cases where the executive shares the net income of the entire business.

Unit profit-sharing seems to be of advantage to those executives whose work is sufficiently independent of others to be accurately reflected by the department's record. Such situations are found in department stores and in producing units that are geographically isolated. Although it affords a stronger incentive, unit profit-sharing seems advisable only where the cost system shows the profits by departments, where the responsibility of the head is clear-cut, and where the department is largely self-contained.

But in most enterprises the activities of the operating organization are so closely interwoven that it is difficult to distinguish between the earnings of individual departments. The situation is further complicated because modern management practice decrees that in respect to certain phases, like personnel, the operating departments shall receive the facilitating help and advice of staff or advisory executives. Still more interdependence is established when activities, such as purchasing, inspection, or maintenance, which are

common to several operating units, are placed in charge of functional departments. It is impossible for the accounting mechanism to isolate the profits created by the work of an individual member of the "top-management" which guides and controls the enterprise as a whole. For these cases the solution is "general profit-sharing" in which the recipients participate in the total income from the operation of the business. Income from the outside investments of other years is usually not shared because it does not reflect the efforts of current management.

The convenient basis for apportioning the fund (Question 4) is salary, but the logical basis is individual performance. In order to judge the work of an executive or manager, a method of rating performance is needed. Although objective rating methods will undoubtedly prove of increasing importance in the future, they are as yet imperfectly developed. Here we can employ the same two expedients which have already been suggested as a means of checking the selection of the managerial group, namely, an analysis of the salary margins over a fixed minimum, and the suggestions of those participating. The use of both of these methods is aided by some arrangement of classes or subdivisions into which eligible participants can be graded in accordance with their contribution to management.

If the participating group is subdivided into classes, the judgment of the chief executive or owner is checked by permitting those in each class to suggest promotions to it. This method of democratic nomination by the group, aided perhaps by a committee, brings to light the value which executives themselves place upon the work of their fellows. Their intimate knowledge of the strengths and weaknesses of those closely associated with them is probably more accurate than the arbitrary judgment of one man. Such a device will function, however, only where the percentage which goes into the fund is fixed. The group must be aware of the fact that their own shares will be less if the effort of the new-

comer is not increased by his inclusion so that he contributes to profits more than he gets back in bonus.

An alternative method to the use of sub-groups is to employ the "salary margin" as a basis for apportioning the fund. This method avoids some of the injustice of using total salaries, and retains the advantages of simplicity and definiteness. It tends to pay high executives in proper ratio to their worth, and to lessen the troublesome difference in total pay between those who are just eligible and those just outside. If $2000 be selected to represent the minimum family requirements for a health and decency standard, the margin above this sum is a rough measure of one man's worth relative to that of another. Where the participants are divided into classes, each of the latter should be assigned a minimum which includes both the "health and decency" standard and an allowance for the social needs of the participants in question. For major executives, the minimum might be placed as high as $5000. Within these sub-groups, the margin above the minimum is an effective basis for distributing the fund.

The form of payment (Question 5) involves the oft-discussed choice of cash or stock. For high executives, cash payments seem preferable; but for the lower ranks of management, common stock has much to recommend it because it prevents the spending of bonuses in advance. The payments should be made annually, if not more often, and should not be on a deferred basis. The deferring of the payments complicates the operation of the plan and does not seem to be compensated for by a decrease in turnover traceable to the deferred features alone.

The proper answer to the question of cash *vs.* stock depends on the convenience of the company in view of its requirements for working capital. If money is not needed in the business to take care of expansion, payments should be in cash. If a business can conveniently pay in cash, and if the recipients are familiar with investment, this form probably provides a quicker incentive than the distribution

of stock; but cash payments should be accompanied by strong inducements to the recipient to invest his bonus in common stock of the company. Only in this way can a proprietary interest be developed if the cash form of payment is employed. Where executives, of their own free will, use their share of profits to buy a "stake" in the company, a strong sense of partnership results.

Unless management problems are actually shared with those who participate in profits, the calibre of management is not improved and the money distributed as bonus is spent unwisely. It is essential that each participant be kept convinced of the opportunities which are available to him to contribute to the business. Not only should he be familiar with questions facing the company, even though they do not touch his own department directly, but he should be encouraged to assist in their solution if qualified. In such an atmosphere, under-executives are trained and broadened, and their loyalty and interest become active, not passive.

Managerial profit-sharing may be designed to provide a financial incentive that will increase individual and cooperative effort. In addition, it may be utilized to develop a sense of proprietorship, and to render the compensation of management more equitable.

TABLE XI—Tabulation of Mana

	Those Eligible to Participate				Deduction from Net Profit Before Sharing With								
	A	B	C	D	A					B	C	D	E
					Percentage on Invested Capital (Capital and Reinvested Earnings)								
	Major Executives, or Officers (under Little or No Supervision)	Principal Assistants, or Department Heads (under Some Supervision)	Minor Executives Who Affect Profits Appreciably, But Who Are under Close Supervision	Other Salaried Employees	5 Per Cent	6 Per Cent	7 Per Cent	8 Per Cent	Miscellaneous	Interest on Bonds or Dividends on Preferred	Percentage of Net Earnings	Percentage on Common Stock	No Deductions
No. 1.		x	x	x									x
2.	x	x	x		x								
3.	x	x										x	
4.	x	x	x	x							x		
5.	x	x	x							x			
6.	x	x	x			x							
7.	x	x	x	x								x	
8.	x						x						
9.		x	x				x						
10.	x										x		
11.	x	x	x						x				
12.	x	x	x							x		x	
13.		x				x							
14.	x				x								
15.	x					x							
16	x	x							x				
17	x	x	x	x					x				
18.	x	x							x				
19.	x	x											x
20.	x	x	x				x						
21.	x	x	x										x
22.	x	x	x							x		x	

DIX A

GERIAL PROFIT-SHARING PLANS

Management	Basis of Apportioning Management's Fund among Participants					Form of Payment				
F	A	B	C	D	E	A Cash			B Common Stock	
						End of Period				
Remarks	Percentage of Individual Salary to Total Salaries of Participants	Fund Split among Sub-groups, within Which Sharing Is on Salary Basis	Individual Performance, Appraised by Chief Executive, Chairman of Board, or Committee	Service	Remarks	Annually	Monthly or Quarterly	Deferred Payments	Paid at End of Period	Deferred Payments
Bonus of Gr. 2(C) is three times Gr. 3 (Col. D)		x	x	x	B. Groups 2 & 3 C. Group 1	x (½)		x (½)		
	x						x			
	x					x				
	x					x				
Also share with rank and file	x								x	
			x							x
			x			x				
			x							x
Same Co. as No. 8			x							x
					Showing of "unit"	x				
	x			x	10% pro-rated on size of family	x				
		x			Relatively larger for high sub-groups	x				
	x					x				
Also share with rank and file	x					x				
Another fund for officers and rank and file together			x	x	90% on service 10% to officers	x				
Percentage unknown			x							
	x					x				
Proposed revision of No. 17		x								
Profit minimum to be earned			x		Applies to "works bonus"	x (½)	x (½)			
	x					x				
Also share with rank and file Wage dividend deducted.	x					x				

No.	Those Eligible to Participate				Deduction from Net Profit Before Sharing With								
	A	B	C	D	A — Percentage on Invested Capital (Capital and Re-invested Earnings)					B	C	D	E
	Major Executives, or Officers (under Little or No Supervision)	Principal Assistants, or Department Heads (under Some Supervision)	Minor Executives Who Affect Profits Appreciably, But Who Are under Close Supervision	Other Salaried Employees	5 Per Cent	6 Per Cent	7 Per Cent	8 Per Cent	Miscellaneous	Interest on Bonds or Dividends on Preferred	Percentage of Net Earnings	Percentage on Common Stock	No Deductions
23.	x				x								
24.	x	x	x	x						x		x	
25.	x										x		
26.	x	x										x	
27.	x	x	x									x	
28.	x									x		x	
29.		x	x	x		x							
30.	x	x	x							x		x	
31.	x	x	x										x
32.	x	x	x							x			
33.	x									x		x	
34.	x*	x	x					x					
35.	x	x				x							
36.		x	x†									x	
37.	x	x	x	x					x				
38.	x	x									x		
39.	x												x
40.	x												x
41.	x§	x	x										
42.	x	x	x							x		x	
43.	x	x										x	
44.	x						x						

* Except Ch. of Bd. † Includes second hands.

XI—*Continued*

Management	Basis of Apportioning Management's Fund among Participants					Form of Payment				
						A			B	
						Cash			Common Stock	
						End of Period				
F	A	B	C	D	E					
Remarks	Percentage of Individual Salary to Total Salaries of Participants	Fund Split among Sub-groups, within Which Sharing Is on Salary Basis	Individual Performance Appraised by Chief Executive, Chairman of Board or Committee	Service	Remarks	Annually	Monthly or Quarterly	Deferred Payments	Paid at End of Period	Deferred Payments
	x				Except top exec.	x				
Percentage on common "reasonable"			x			x				
Mgt. shares before dividends						x				
			x		Bonus of top exec. relatively larger	x				
Proposed revision of No. 26	x									
			x			x				
	x				In excess of $1000				x	
	x					x				
	x					x				
	x					x				
						x				
After taxes	x (‡)		x (‡)					x		x‡
After taxes and penalties for variation from standards					Profits of "unit"	x				
	x					x				
Percentage unknown			x			x				
			x	x		x				
			x							
No deductions except reserves and taxes	x					x				
	x						x			
After reserve for amortization of preferred			x			x (‡)				x (‡)
		x								

‡ If company wishes. § Not stockholders.

No.	Those Eligible to Participate				Deduction from Net Profit Before Sharing With									
	A	B	C	D	A — Percentage on Invested Capital (Capital and Reinvested Earnings)					B	C	D	E	
	Major Executives, or Officers (under Little or No Supervision)	Principal Assistants, or Department Heads (under Some Supervision)	Minor Executives Who Affect Profits Appreciably, But Who Are under Close Supervision	Other Salaried Employees	5 Per Cent	6 Per Cent	7 Per Cent	8 Per Cent	Miscellaneous	Interest on Bonds or Dividends on Preferred	Percentage of Net Earnings	Percentage on Common Stock	No Deductions	
45.	x	x												
46.	x	x	x				x							
47.	x	x	x											
48.	x	x	x	x						x		x		
49.	x	x	x			x								
50.	x													
51.	x	x						x						
52.	x						x							
53.	x	x	x			x								
54.	x	x							x					
55.	x	x	x							x				
56.	x	x											x	
57.	x	x	x						x					
58.	x								x					
59.	x	x						x						
60.	x	x								x				
61.	x	x	x											
62.		x								x		x		
63.	x									x				
64.	x	x								x				
65.	x	x								x				

*Trustees certificates redeemable in securities.

XI—*Continued*

Management	Basis of Apportioning Management's Fund among Participants					Form of Payment				
F	A	B	C	D	E	A Cash			B Common Stock	
						End of Period				
Remarks	Percentage of Individual Salary to Total Salaries of Participants	Fund Split among Sub-groups, within Which Sharing Is on Salary Basis	Individual Performance, Appraised by Chief Executive, Chairman of Board or Committee	Service	Remarks	Annually	Monthly or Quarterly	Deferred Payments	Paid at End of Period	Deferred Payments
	x					x				
			x			x (½)			x (½)	
Fixed amount deducted			x			x				
6 per cent on market value of common		x								
		x				x				
Percentage unknown			x			x				
						x				
7½ per cent (1 per cent higher than preferred)						x				
4 per cent additional to sinking fund		x				x				
10 per cent	x		x		Part by each method	x				
All authorized expenses deducted	x					x				
			x			x				
		x			16 sub-groups					x*
Percentage above normal level of profits	x					x				
			x			x				
	x					x				
Fixed sum	x					x				
	x				Or fixed percentage of fund	x				
After all expenses (taxes, losses, depreciations)		x				x†	x†			
		x			Each one suggests % share for others		x			
		x			Same as above	x				

† Funds divided into 2 parts.

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